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# Wielders of mass deception?

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# Politics this week

Oct 2nd 2003
From The Economist print edition

## Under investigation

The White House said that it would co-operate fully with an **FBI investigation** into allegations that its officials had deliberately leaked the name of an undercover CIA officer to the media, a criminal offence. The officer is the wife of Joseph Wilson, a diplomat and former National Security Council director for African affairs, who undermined the administration's claim in January that Iraq had tried to buy uranium from Niger.

See article: How things have got tougher for George Bush

The US Census Bureau released data showing that a further 1.7m Americans had fallen below the federal **poverty** line in 2002. America's poverty rate is now 12.1% for the total population, rising among blacks to almost 25%.

See article: Chilly economic figures

Campaigning in **California's** recall election reached a heady climax. Arianna Huffington, an independent candidate, withdrew from the race and threw her support behind Governor Gray Davis. Mr Davis's likely successor, Arnold Schwarzenegger, at last received the endorsement of the state's Republican Party.

Reuters

See article: The state of California

America rejoined **UNESCO**, the United Nations agency that promotes education and culture. It withdrew in 1984 over concerns that the agency was mismanaged and anti-capitalist.

A third person was arrested over possible **espionage** at Guantanamo Bay military camp. The civilian translator assisted with the interrogations of al-Qaeda and Taliban suspects.

## Another brick in the wall

The Israeli cabinet decided that its controversial "**security wall**" should be built round Ariel, a large settlement that is deep in the occupied West Bank. Israel also unveiled its plans to build more than 600 new homes in three West Bank settlements.

The Israeli army killed a member of **Islamic Jihad**, and captured another, in two separate raids on the West Bank.

**Ahmed Qurei**, the Palestinian prime-minister designate, appointed a new cabinet to be presented for parliamentary approval next week.

At a trial in Belgium, 18 **al-Qaeda** suspects received prison sentences, and five were acquitted. One, a Tunisian, was jailed for ten years for involvement in a plot to blow up a military base in Belgium housing American soldiers; a second Tunisian was sentenced to six years for organising the recruitment of al-Qaeda volunteers in Europe.

A demonstration by **unemployed Iraqis** in central Baghdad turned violent. Officials say it may take a

year before a new Iraqi constitution can be drawn up. A committee began preparing the ground for a constitutional convention but agreement has been limited.

See article: Iraq's delayed reconstruction

America drew up a slightly revised version of its draft UN resolution on **Iraq**. Initial responses were not enthusiastic.

Parliamentary elections were held in **Rwanda**, the first since the genocide in 1994. The ruling party, the Rwandan Patriotic Front (RPF), won easily with 74% of the vote, partly because of a muzzled press and curbs on the opposition. The RPF's leader, Paul Kagame, was elected president last month, with 95% of the vote.

To kick-start an anti-corruption campaign, **Kenya's** president, Mwai Kibaki, declared his wealth. All 70,000 Kenyan civil servants must now do the same, but none of these statements will be made public. A commission said that half the country's judges were corrupt.

## Through the ceiling

The **French** government presented its budget for next year, confirming that it would cut income tax by 3% and that the public deficit would reach 3.6% of GDP, well above the euro zone's 3% limit for the third year in a row.

See article: France's rising Euroscepticism

**Germany's** chancellor, Gerhard Schröder, again said that he would resign if left-wingers among his ruling Social Democrats stopped him from pushing through his reform package by the end of the year.

See article: Two German state leaders show the way to reform

The **Danish** government said that it may hold a “super referendum” on the European constitution and the euro next year.

**Italy's** three main trade-union groups called a four-hour strike later this month in protest at the government's plans to reform state pensions. On September 28th, one of the biggest electricity blackouts in the country's history, caused by a falling tree in southern Switzerland, left most of the country in the dark.

Fears grew for the health of **Pope John Paul**. He recently appointed 31 new cardinals, most of them conservatives, presumably to ensure a likeminded successor.

See article: The pope's succession planning

## UN invited

Razali Ismail, a UN envoy, visited **Myanmar**, hoping to secure the release of the jailed democracy leader and Nobel peace laureate, Aung San Suu Kyi. With an ASEAN summit set to start shortly, the government is under strong pressure to act.

John Howard, **Australia's** prime minister, reshuffled his cabinet. In a controversial move, the immigration minister, Philip Ruddock, was promoted to attorney-general.

Roh Moo-hyun, **South Korea's** president, left the ruling Millennium Democratic Party. His decision comes ahead of the parliamentary elections in April and after the splitting of the party.

See article: South Korea's ruling-party meltdown

**North Korea** said it was taking “practical measures” to strengthen its nuclear “deterrent”. Its foreign minister said it had re-pressed 8,000 nuclear-fuel rods, which could be used to make up to six bombs.

But he said the North had no intention of transferring nuclear technology to any other country.

In an improvement of personal freedoms, **China** relaxed its marriage rules. People can now wed without permission from their employers and without a medical check.

## Misiones accomplished

Néstor Kirchner, **Argentina's** president, scored a political victory: in a closely watched contest for governor of Misiones province, an independent supported by Mr Kirchner defeated the official Peronist candidate backed by Eduardo Duhalde, Argentina's former president.

See article: The president seeks allies

**Brazil's** left-wing president, Luiz Inácio Lula da Silva, visited Cuba, signing agreements with Fidel Castro aimed at boosting trade between the two countries. In Paris, meanwhile, a galaxy of left-wing writers and artists attended a rally in protest at Mr Castro's repression of dissidents.

Reuters

See article: Biotech and farming in Brazil

Teachers went on strike for higher wages in **Bolivia**, joining protests by disgruntled peasants at a plan to export natural gas to the United States. A call for a general strike otherwise received only limited backing.

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# Business this week

Oct 2nd 2003
From The Economist print edition

## The sky's the limit

Two of Europe's biggest airlines joined forces as Europe and America began discussions on an “open skies” agreement to liberalise air travel between the two markets. State-controlled **Air France** is to buy **KLM Royal Dutch** in an all-share deal worth some *euro*784m ($913m). Italy's Alitalia said that it wants to join the alliance once plans for its privatisation are finalised.

See article: Air France and KLM get close

**Wm Morrison**, a British supermarket chain, was handed the opportunity to acquire Safeway, a rival retailer, after the British government blocked the country's three leading supermarket operators from buying the smaller chain. But Tesco, J. Sainsbury and Asda will compete fiercely to buy 53 Safeway stores that are likely to be sold as a condition of the deal going ahead.

See article: Supermarket competition

**Alstom**, a beleaguered French engineering company in the throes of a controversial government bail-out, sold its power-transmission and distribution unit for *euro*950m ($1.1 billion) to **Areva**, a state-owned nuclear-power firm. The deal may face close scrutiny as the sale to a state-run enterprise could constitute a form of state aid.

## Full and Frank disclosure?

Corporate America went on trial. **Frank Quattrone**, once CSFB's star technology banker, is accused of ordering the destruction of e-mails that had been subpoenaed in a government investigation into suspect initial public offerings. **Dennis Kozlowski**, a former chief executive of Tyco, and his chief financial officer are accused of looting the industrial conglomerate of $600m.

See article: America's corporate scandals

**Prudential Securities**, America's third-largest brokerage, asked for the resignation of 12 employees said to be involved in improper mutual-fund trading after an internal investigation. Eliot Spitzer, New York's attorney-general, is investigating similar practices that have cost ordinary investors billions of dollars.

America's Securities and Exchange Commission sought more evidence relating to corporate involvement in the collapse of **Enron**. The regulator went to court in order to procure documents from Kenneth Lay, the former energy trader's erstwhile chief executive. He has refused to hand over the papers, citing his Fifth Amendment rights against self-incrimination.

## Setting Sun

Shares in **Sun Microsystems** plunged after it revealed that a charge of over $1 billion had wiped out profits in the latest quarter. The network-equipment maker also gave warning that it was heading for a hefty loss in the next quarter. Sun has been hit by the decline in tech spending and stiffer competition from rivals.

See article: Spending on information technology

**Ford's** fears for the future were underlined. The car giant said that it would cut 3,000 jobs at a plant in Belgium and a further 1,700 employees would go from its German division. It added that 3,000 workers would be axed in America before the end of the year as part of a previously announced restructuring.

**Alcan**, a Canadian aluminium group, got permission from regulators in Europe and America to go ahead with a *euro*4 billion ($4.7 billion ) takeover of Pechiney, a French rival. Both sets of regulators insisted on some divestments as a condition of the deal.

**Ahold** at last unveiled its accounts for 2002. The Dutch retailer, hit by an accounting scandal at its US Foodservice unit, made a loss of *euro*1.2 billion ($1.1 billion) for the year after charges of *euro*3.2 billion, mainly related to the American subsidiary.

## Getting offboard

Jürgen Schrempp, boss of DaimlerChrysler, followed Carl McCall in resigning from the board of the **New York Stock Exchange**. Other board members may go in the wake of the controversy over the whopping pay-packet awarded to Richard Grasso, the exchange's former boss.

**Manulife Financial**, a Canadian life insurer, announced an $11 billion all-share takeover of America's **John Hancock Financial Services**. **Fortis**, a Dutch-Belgian financial group, also announced that it would float its American insurance business.

See article: Manulife buys John Hancock

## Money in the banks

Shares in **Japan's big banks** soared. It seems that the country's improving economy could further the ability of companies to pay off loans and reduce debt defaults. But the banks' shares have risen from a very low base and the problem of bad loans is far from fixed.

The Bank of Japan apparently intervened in currency markets to weaken the **yen** for the first time since a G7 meeting in September which called for exchange rates set by the market. Japan's government had spent ¥13.5 trillion ($114 billion) so far this year to keep the currency down and assist an export-led recovery. But the yen hit a new three-year high against the dollar.

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Those elusive Iraqi weapons

# Wielders of mass deception?

Oct 2nd 2003
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**There was a good case for deposing Saddam Hussein, but Britain and America stretched it**

AP

THE road to war with Iraq was paved with arguments, good and bad. Among the many good ones were Saddam Hussein's serial invasion of his neighbours, his neglect and murder of his own people, and his recidivist disregard for the umpteen UN resolutions passed in the hope of domesticating him. But there were some less good arguments advanced by the governments that ousted him. George Bush and Tony Blair, it now appears, exaggerated the threat posed by Iraq's weapons of mass destruction (WMD). This is not just a negligible footnote in the history of Iraq's conquest and reconstruction—so much propaganda under the bridge. In the eyes of the world, especially the Arab world, the flimsiness of some of the claims about Mr Hussein's arsenal has helped to make a legitimate conflict seem otherwise. It also risks making the danger posed by WMD seem more rhetorical and less real than it is, and may jeopardise future efforts to deal with that danger, especially any that involve acting pre-emptively. Ultimately, weaknesses in the Anglo-American case risk damaging the limited trust that Britons and Americans place in their leaders.

They may also have more tangible political consequences. Mr Bush's popularity has been hit by the costs and complications of the post-war occupation, but thus far Mr Blair has faced more flak over his case for war. As the presidential election approaches, and more light is shone into both Mr Bush's case and the way the White House dealt with its critics, the balance of political risk may well change.

## The good, the bad and the exaggerated

Mr Bush and Mr Blair, remember, were only supporting witnesses in the argument that Mr Hussein coveted and probably retained WMD. The main evidence came from the UN weapons inspectors, aided and abetted by Mr Hussein himself. Those with the inclination and stamina—of whom, before the war, there were few—can immerse themselves in more than a decade's worth of reports that detail Iraq's WMD history. Despite brazen efforts to obstruct them, in the 1990s the inspectors uncovered, among other things, Iraq's biological-weapons programmes. The shenanigans continued when the inspectors returned to the country in 2002. As well as acting guilty right until the end, Mr Hussein had used WMD in the past. Very few people believed that he had given them up of his own accord. *The Economist* was not among them.

But the inspectors' findings were too arcane to be turned into soundbites. And in the end, they amounted to a set of alarming questions about what Mr Hussein might be hiding, rather than firm statements. So Mr Blair and Mr Bush levelled some accusations of their own, based on what their spies told them (see article). America, for instance, made frightening allegations about the progress of a Saddamite nuclear bomb, and Iraq's links to al-Qaeda. Both governments had other reasons for wanting to change Iraq's regime, which, in the weapons' absence, they are now busily stressing; but the case they made to the world was firmly anchored in the WMD threat.

Six months and a war later, the American-led post-war inspectors were expected to tell Congress this week that Mr Hussein's missile programmes and procurement efforts did indeed breach UN resolutions, and offer other proof of his duplicity. Yet no actual WMD have come to light, let alone the terrifying arsenal the world was led to expect. Even many who opposed the war are shocked and awed by this,

especially by the apparent absence of the chemical weapons Mr Hussein was widely believed to have retained. Like inquisitors condemning a witch, some argue that this failure to find very much simply confirms Mr Hussein's cunning. That is not good enough. By adding their own, intelligence-based allegations to those of the UN's inspectors, Messrs Bush and Blair shifted part of the burden of proof from Mr Hussein to themselves.

## Their own worst enemies

Two questions are raised by the elusiveness of the WMD. The first concerns Saddam. Why, if he had so little to hide, did he subject his country to all those years of sanctions and bombings, and finally to the war that dislodged him?

One explanation is that Mr Hussein intentionally created uncertainty about his arsenal: adversaries might be deterred, while his guilt could never be categorically proven. This strategy may have extended to the issue of fake orders to his commanders to unleash chemical weapons, in the hope that they would be overheard and deter the invasion. Or this self-proclaimed heir of Saladin and Nebuchadnezzar may have been unwilling to face the shame of submitting to the UN, and did not give a fig about what his machismo cost his people. Or, as can be the fate of dictators, Mr Hussein's minions may have led him to believe that he had a bigger punch, and more to hide, than he actually did. When war was on his doorstep, they may have been too cowed to tell him the truth.

The second question concerns the governments of Britain and America: why did they makesome claims that now look exaggerated? Did the spies get it wrong, or did the politicians lie about what the spies told them? Unless more intelligence is declassified (and it should be), it is hard to make a definitive judgment; but parliamentary and congressional probes, and a British public inquiry, enable an interim one. Both were culpable. The spies erred and the politicians exaggerated.

Iraq was, in spook parlance, a “hard target”. Reliable, on-the-ground intelligence was hard to come by, as is inevitable in a country where minor disloyalty was punishable by death, or worse. But that doesn't get the politicians off the hook. Intelligence, like those UN reports, tends to deal in subjunctives: it often speaks of what might or could be going on rather than what definitely is. Politicians, on the other hand, prefer indicatives or imperatives. What in some cases began as nuanced reports became much more certain; and while both Mr Bush and Mr Blair often spoke, quite reasonably, of future dangers and of possible threats, they sought as well to grab the attention through more specific claims. It also seems possible that some dated intelligence was used to portray a current menace. In the case of the al-Qaeda connection, Mr Bush's team wilfully over-interpreted the little proof they had.

This impression of cavalier behaviour, especially on the part of the Americans, may yet be dispelled—either by a fuller disclosure of the intelligence, or by further discoveries in Iraq. Indeed, it would be astonishing if no such discoveries were made. But judging by the way some British and American officials have been playing down expectations—sliding from talking about actual weapons to discussing weapons programmes and plans—they are not overly optimistic. Even if some WMD are found, many of the specific Anglo-American claims seem unlikely to be vindicated.

The response of some cynics is that governments are always economical with the *actualité*, especially when selling a controversial policy—and the Iraq war, a war of choice, fought in spite of much of the world's disapproval, was an especially hard sell. The reverse is true: the standards of accuracy and sobriety should have been all the more scrupulous because of the controversy, and because so many lives were at stake. The war, we still think, was justified. But in making the case for it, Mr Bush and Mr Blair did not play straight with their people.

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Tony Blair's leadership

# Bruised, but bouncing back

Oct 2nd 2003
From The Economist print edition

**Tony Blair's not on his way out, but it's not clear where he's going**

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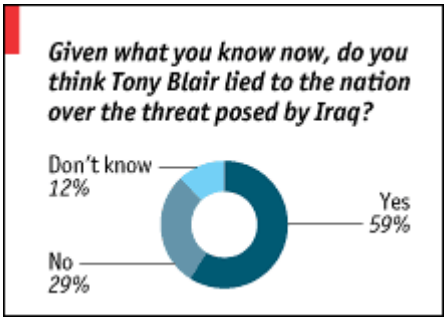


THERE'S something rather thrilling about watching Tony Blair on form. There he is, facing his party's annual conference, bloodied by the failure to find any Iraqi weapons of mass destruction, the corrosive effect of the Hutton Inquiry and the war's messy aftermath; with Labour traditionalists who oppose his market-oriented policies out to pull his domestic agenda apart; with the press announcing his imminent replacement by his ambitious chancellor of the exchequer, Gordon Brown. And yet his brilliant showman's sense catches the audience's mood with a speech that is bruised, touched with humility, but above all defiant. He is unrepentant about Iraq and apparently determined not to give an inch of ground on his domestic agenda to his critics. “I have no reverse gear,” he said. Most of the audience loved it, though the metaphor doesn't bear too much consideration: as a BBC commentator pointed out afterwards, if you are on the edge of a cliff, a reverse gear is quite useful.

Still, displays of bravado do not answer the fundamental question. Is Mr Blair now so damaged that he is no longer an asset to his party, but a liability? The trust of the electorate is hard to earn and easy to lose. If poll after poll is to be believed—according to an NOP poll this week (see chart, above), nearly two-thirds of voters believe he lied to them over Iraq—the prime minister has forfeited it. Some people think that this loss of moral stature will, and should, bring Mr Blair's political career to an end.

## Going nowhere

It won't and it shouldn't. While Mr Blair—arguably Labour's most successful leader ever—deserves criticism for the way the government presented its case for war with Iraq, there is no evidence that he lied. For all the obsessive interest in the minutiae of September 2002's dossier on Iraqi capabilities and intentions, nothing has emerged to suggest that Mr Blair's belief in the threat posed by Saddam Hussein was anything other than heartfelt. Whether or not it was right to fight the war remains a matter of judgment. But although hindsight shows how the prime minister might have done some things differently and better, his sincerity should not be in question.

This is crucial for Mr Blair. For all the passionate opposition to the war among some Labour Party activists, even those who think that he made a terrible mistake appear ready to concede that at least he thought he was doing the right thing, and that he thought he had good grounds for that belief. Mr Blair's explanation in his speech to the conference of his decision to go to war was listened to with respect, understanding and even some applause. His reception overall, culminating in a seven-minute standing ovation at the end of a speech in which he had not ducked any of the difficult issues, was a deliberate message to the outside world. The Labour Party still wants Mr Blair to be its leader and will not allow him to be destroyed over Iraq. His achievement is to have made Labour feel for the first time in its 103-year history that it can be “the natural party of government” and it is sufficiently grateful for that not to desert him in his hour of need.

None of which means that the prime minister's recent difficulties are at an end. Mr Blair remains at odds with much of his party and the trade unions over his plans for public services. In particular, he still faces intense opposition to his efforts to give hospitals some independence from bureaucrats, within the National Health Service. A motion opposing these “foundation hospitals” was passed at the conference.

That won't make any difference to government policy; but a possible Commons defeat over its plans to charge students some of the costs of a university education certainly would.

In the course of his speech, Mr Blair talked about the need for a government half way through its second term of office, and with every prospect of achieving a third term, to find the resources to “renew” itself. If that means more of what Mr Blair says he believes in, it will mean more competition between providers in health and education; looser Whitehall control on pretty much everything that goes on in the public sector, including greater powers for local government to raise money and decide what to do with it; an end to the centralisation of public-sector pay which means that teachers in expensive London get paid pretty much the same as teachers in western Scotland. Such changes would do the country a lot of good, and be fiercely resisted by the party and the unions.

Here lies Mr Blair's difficulty. Although the Labour Party made it clear this week that it is happy for him to be its leader, it has made it equally clear that it is unwilling to go where he wants to go. He says he's not reversing. The Labour Party doesn't want to go forward. Unless he can resolve that problem, Britain is not likely to go anywhere.

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**Aviation liberalisation**

# Open the skies

Oct 2nd 2003
From The Economist print edition

### Now is the time to set the world's airlines free

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IT IS a striking paradox that the aviation industry, which has done so much to help create a global economy, is itself stuck in a mercantilist past dominated by national pride and special interests. Sure, shiny planes fly everywhere, looking the very symbol of modernity. But the structure of the industry and the way it operates have largely been dictated by a web of government rules more appropriate to the 16th century than the 21st. For the past 60 years, air travel has been governed by inter-governmental deals which dictate which airlines can fly where, how many seats they can offer and even, in many cases, what fares they can charge. The result has been inefficiency, financial losses and forgone consumer benefits.

This week the European Union and America began negotiations about overhauling the agreements which entangle air traffic across the Atlantic (see article). The talks are a golden opportunity to free, at last, not just their airline industries, but the world's. After years of empty rhetoric about “open skies”, both America and the EU should finally dismantle this costly and anachronistic system. Together they account for half of all air travel. So if they act boldly enough, most other countries would be likely to follow.

The industry's current plight is dire. It has been battered by terrorism, economic slowdown, war fears and the SARS epidemic, as well as heavy-handed regulation. Total airline losses are expected to reach as much as $10 billion this year. So this may seem like a strange time for radical deregulation. But such a crisis is often the most effective trigger for fundamental reform. Aviation desperately needs to be freed from government constraints, to cope with the many storms it inevitably encounters, as well as to find the best way to serve passengers. As a whole the industry has never returned the full cost of its capital—in other words, it has regularly destroyed more wealth than it has created, a damning indictment of the government meddling which has bedevilled it for so long.

This is a shame, because the industry clearly does not suffer from any lack of entrepreneurial spirit. Domestic deregulation in the United States and Europe produced an explosion of low-cost carriers and clever new strategies. In both cases these created new routes, more passenger traffic and lower fares. It seems certain that international deregulation would yield the same result. Even Europe's remaining state-owned carriers, long coddled by subsidies and regulation, have been straining at the leash, using lean, internet-based booking techniques learned from low-cost upstarts and struggling to circumvent government rules in order to strike cross-border alliances or quasi-mergers, as Air France and KLM have done this week.

And yet existing rules make it impossible for airline managements to pursue the kind of sweeping, market-driven reorganisation which the industry so badly needs. With too many national governments still determined to prop up “flag carriers”, the efficient cannot prevail nor the weak go to the wall. The language of existing aviation treaties may seem arcane, but they were largely produced by the trading of political favours and their intention is unmistakable: protectionism and the restriction of competition. Officially, both the United States and the European Union say they want to scrap this approach altogether, and leave in place only technical and safety rules. For once, they should be true to their word, and seize the chance to sign a short and simple deal. Rule number one: there shall be no rules, other than that of the market.

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Europe's future

# Roman carnival

Oct 2nd 2003
From The Economist print edition

**How Europe's leaders should improve their draft constitution**

A BIG jamboree of European heads of government in Rome this weekend will open the final negotiations on a new constitution for the European Union. A draft of such a document has been prepared over the past 18 months by a convention, chaired by Valéry Giscard d'Estaing, a former French president. The Italian EU presidency hopes to complete the work by mid-December, though March may be a more realistic goal (see article). Given this time constraint, how should Europe's governments change the draft constitution?

The convention's text was an inelegant, often incomprehensible and ultimately disappointing document that satisfied neither out-and-out federalists nor those who wanted to stop Europe's drive towards ever closer union. That is why, in June, this newspaper called for it to be binned, and for work to begin instead on a simpler, clearer constitution that would genuinely bring Europe closer to its people. Sadly, this is unlikely to happen now. So Europe's governments should treat the convention text not as a definitive constitution—that will be for another day—but as, in effect, just another treaty, like those of Maastricht, Amsterdam and Nice.

Their first priority should be to toughen provisions on “subsidiarity”, the doctrine that government action should take place at the lowest sensible level. The draft constitution purports to favour subsidiarity. It says correctly that all EU powers derive from member countries. But it provides only that, if one-third of national parliaments object that the European Commission is breaching subsidiarity, the commission should review its plans. A stronger safeguard would be to make the commission withdraw any proposal which three or more national parliaments deemed in breach of subsidiarity.

Next, the draft should jettison the prolix Charter of Fundamental Rights, which either duplicates existing European human rights or creates uncalled-for new ones (eg, to a job-placement scheme or a high level of consumer protection). The text should also be crystal clear that such contentious issues as tax and foreign policy will remain subject to unanimous vote. An attempt in the draft constitution to fudge this point and open the way to majority voting risks merely stoking up opposition. Also, the new EU foreign minister ought to report unambiguously to national governments in the Council of Ministers, not to the civil servants of the commission, of which he will be a member. And more must be done to ensure that European defence policy supports rather than undermines NATO.

As important as changes that should be made are two changes that should not be. The draft constitution cuts the number of voting European commissioners to 15. But a bevy of the EU's existing and prospective smaller members insist on keeping their own commissioner. A commission of 25 or, later, 30 would be too big and have too little to do. It would also entrench the undesirable notion that commissioners are there to do battle for national, not European, interests. That is the job of the Council of Ministers, not the commission.

As for the council, Mr Giscard d'Estaing's draft proposes simpler and fairer voting: a “double majority” of a majority of member countries, representing three-fifths of the EU's population. But Spain and Poland want to go back to the more complex voting system agreed in the Nice treaty, because it gave them 27 votes each against only 29 for Germany, which is twice as populous. This Spanish/Polish bid to keep disproportionate voting power must be faced down.

## Ratification blues

Whatever constitution Europe's governments produce, plenty of hurdles remain before it is ratified, as it must be, by all 15 current members, plus the ten new ones joining next May. At least six, and probably more, countries will submit it to a referendum. Experience suggests that some are likely to say no. Naysayers should be listened to, rather than just asked to vote again or, worse, chucked out of the club. That means that, within a few years, there is likely to be another chance to revisit Europe's constitution. By then it will also be possible to learn from the experience of operating an enlarged EU of 25.

The model that may then emerge will be of a Europe moving at varying pace. Those that want to forge ahead (as “pioneers”, in the latest phrase) to more common policies should be allowed to do so, provided they neither force hangers-back along too, nor block them if they change their minds. Whether in defence, monetary matters or immigration rules, there is no harm in a Europe of 25 or 30 moving at different speeds—so long as all have a chance to hop aboard when they choose.

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European interest rates

# The Excessively Cautious Bank

Oct 2nd 2003
From The Economist print edition

**In monetary policy, actions speak louder than words**

AP

WIM DUISENBERG chaired his last monetary-policy meeting as the president of the European Central Bank (ECB) this week, before he hands over to Jean-Claude Trichet in November. The bank's press conferences are thus likely to be less exciting in future: Mr Duisenberg's gaffes have often rattled financial markets. And under his leadership, the ECB is also widely blamed for Europe's dismal economic performance. But it would be wrong to conclude that a central bank's monetary policy is only as good as its boss. The ECB has done a better job than is generally thought.

Many critics (including, at times, this newspaper) have argued that the ECB has been too slow to cut European interest rates. America's Federal Reserve has cut American rates by twice as much as the ECB over the past three years. Mr Duisenberg's hawkish tones have also reinforced the idea that the ECB consists of a bunch of inflation nutters. He once absurdly suggested that deflation was a “central banker's paradise”. And yet by many measures, the ECB's policy does not seem too tight. One widely used test is the so-called “Taylor rule”, which calculates the “correct” interest rate according to the amount of spare capacity in the economy and the inflation rate. A study by J.P. Morgan Chase concludes that, while the Fed's policy has broadly matched the Taylor rule in recent years, the ECB has actually cut interest rates by more than the Taylor rule would have prescribed.

Another claim is that the ceiling of the ECB's inflation target, of less than 2%, is too low. If the ECB had a higher target, in line with most other central banks, it could have cut interest rates by much more. In practice, though, the ECB has been a softer touch: during the past three years inflation has been below 2% in only five months. Yet doesn't the euro area's sluggish growth prove that interest rates have been too high? It is true that Europe's GDP growth has been much slower than America's, but these figures are distorted by America's faster population growth. Since the euro was launched in 1999, GDP per head in Europe has grown at exactly the same average pace (1.5% a year) as in America.

If policy has been too tight anywhere, this is true of fiscal rather than monetary policy. Europe's “stability and growth pact” forced governments to raise taxes during the economic downturn. But even here, things are not as tight as they seem. In the past year, Germany, France and Italy have broken the pact's ceiling on deficits of 3% of GDP. As long as this breach does not become reckless, or chronic, it should be welcomed.

## People who live in glass houses

This defence of the ECB does not mean it is perfect. Far from it. Soon after he assumes the president's chair, Mr Trichet ought to set a higher inflation target with a mid point, rather than a ceiling of 2%, to guard against the risk of deflation in individual member countries, such as Germany. The ECB also needs to take more account of the rising euro, which is causing monetary conditions to tighten and so should, if it continues to rise, require the ECB to lower interest rates.

Other criticisms of the bank, though, seem weaker. Many argue that it needs to become more transparent. Yet it already is more transparent than the Fed: it does at least have a clearly defined inflation target and holds regular press conferences. Alan Greenspan, the Fed's chairman, gets away with his opaque utterances only because he is still seen by many people as almost divinely infallible. The ECB's focus on monetary growth in addition to its inflation goal is often criticised as undermining its transparency. Yet keeping an eye on the pace of growth in money (and hence credit) can provide a useful check against asset-price bubbles, which have clobbered Japan in the late 1980s and America in the 1990s.

Today the ECB may want to avoid the situation in America, where big interest-rate cuts have encouraged a huge build-up in debt, increasing the risk of a harder economic landing when rates start rising. The Fed's monetary policy of recent years is much admired, yet arguably it helped to create the stockmarket bubble of the 1990s and is currently feeding a housing bubble. The truth may be not that the ECB that has cut interest rates too little, but that the Fed has cut them too much.

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California's recall election

# Has it come to this?

Oct 2nd 2003
From The Economist print edition

**If only the Golden State could get the government it deserves**

AP

NEXT week's recall election, in which Californians will decide whether to sack their Democratic governor, Gray Davis, and replace him with someone more to their liking, may look like a circus. But it is no joke. This election is taking place in the most dynamic part of the world's most powerful country. It is also happening in a state that sets trends—from Reaganism to referendums—that ripple not just across America but across the world. So by all means chuckle at the absurd rules and implausible candidates for the show on October 7th; but also be ever so slightly afraid.

California has almost everything in its favour. It combines a variety of sunrise industries that no country can match: not only Silicon Valley and Hollywood (though most countries would kill to have one economic cluster half the size of either), but biotechnology, aerospace, alternative energy. Immigrants continue to flood in, 11m of them in the past decade alone. From Iowa to India to the dusty farms of southern Mexico, California is still a beacon.

Yet misgovernance dims it. In the last fiscal year, California set a new record in budgetary incompetence with a shortfall of $38 billion. Where has that money gone? From business's point of view, Mr Davis has delivered mostly more regulation, administered by an army of (Democrat-supporting) public employees. By contrast, very little cash seems to have gone into rebuilding the state's infrastructure. In 2001, California's electricity system collapsed. The roads around Los Angeles and Silicon Valley often seem like parking lots, and the state's schools are lousy.

Much of this is due to the fact that California is a one-party state. Democrats control all the main statewide offices, kept in power by the most dysfunctional state Republican Party in the nation. And political disengagement runs even deeper than elsewhere in America. In any normal unArnolded election, fewer than a third of the residents bother to vote. Many of the richer whites, clustered in gated communities, have in effect seceded from state government. At the other end of the scale, Latinos, who make up a third of the population, assume that politics is irrelevant and only small numbers of them vote.

Above all, ballot initiatives (for which this paper has some sympathy in principle) have multiplied so fast as to make good government impossible. More than 600 initiatives have been circulated over the past two decades; many that have passed, including those curbing taxation and introducing term limits, have hog-tied the elected representatives in Sacramento.

## A gamble on Arnie

In normal circumstances, this newspaper would rush to dispatch incompetent Mr Davis. In the present circumstances, though, our finger trembles on the trigger. First, the recall vote is unfair. To survive the first ballot, Mr Davis needs to get a clear majority; whoever wins the second round merely needs to finish first. Second, consider the precedent that Californians will set. The recall system was devised to deal with corrupt or criminal governors. Mr Davis is neither, and is no more incompetent now than he was 11 months ago when he won a fair election fairly. Replacing temporarily unpopular leaders at will does little to encourage long-term vision.

As for his replacement, only three candidates stand out. Cruz Bustamante, the lieutenant-governor and the only Democrat in the race, would be the first Latino governor in the modern era, and high time too; but Mr Bustamante is simply Mr Davis rechristened, and seems, if that is possible, even more in hock to special interests. On the other side of the counter are Tom McClintock, a relatively intelligent die-hard Republican whose views on abortion make him unelectable; and Arnold Schwarzenegger.

The Gubernator, far ahead in the latest polls, has several things in his favour. He is a moderate Republican, who takes a liberal stance on social issues such as abortion and gay rights but seems keen to streamline state government. He has assembled an experienced team of advisers that includes Warren Buffett and Milton Friedman. And he performed at least adequately in the only TV debate in which he has taken part. On the other hand, given his lack of political experience, it is hard to pretend that choosing him is anything other than a gamble.

But maybe, just maybe, that is what California needs. Governor Arnie would at least persuade Californians to pay more attention to what is going on up in Sacramento; and perhaps to ponder how on earth a place that is so admirable in so many ways has come to have such a lousy government.

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# Letters

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From The Economist print edition

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## Islam's grievances

SIR – Your survey of Islam and the West (September 13th) fails to outline the three key grievances that drive political Islam. First is the history of western imperialism which denied Muslims independence and freedom for well over half a century. Second was the solution to the Holocaust perpetrated by Europeans on European Jews—handing the British colony of Palestine to Jewish colonists, who then perpetrated their own programme of ethnic cleansing. Third was the exploitation of oil by the West, carried out with the connivance of local puppets who traded the independence of their people in return for being kept in power and skimmed off part of the oil profits for themselves (after the western oil firms took their massive cuts).

Historical grievances, not religious ones, are expressed today through religion—the only political route allowed. Tens of millions of Muslims view the invasion and colonial occupation of Iraq as simply a rerun of the 1920s, when Britain parachuted in its puppet dictator in order to control the Iraqi oilfields, after carving off Kuwait better to control the region.

Hendrik Weiler
Cairo

SIR – You give a precise figure of 284.4m for the number of people living in the countries of the Arab League. Readers may think that this is the number of Arabs living in those states, and that they are all Muslims. This is not true. Some members boast very large non-Arab minorities (40% in Morocco and 30% in Iraq), or have almost no Arabs (Somalia). In countries such as Sudan, Muslims and Arabs are a minority despite the fact that they dominate that state's politics. A more accurate figure for the number of Arab Muslims today is 190m-200m, constituting no more than 17% of Muslims worldwide.

Mike Izady
New York

## Uribe confronts terror

SIR – Colombia welcomes the Human Rights Watch report on child soldiers as confirmation of the valuable work done by certain human-rights groups in this country ("The children's stories", September 20th). As evidence that Colombia's current and past governments have listened to human-rights groups, a law came into effect in 1999 which prohibits anyone under 18 from serving in the armed forces, even if they have the permission of their parents. This law is part of efforts to improve the quality of our soldiers. This, combined with extensive human-rights training, brought about an 84% reduction in the number of allegations of human-rights abuses filed against the armed forces compared with a decade ago.

The heartbreaking and dangerous path which a handful of very young people have chosen or been forced into makes our policy of aiding those who decide to desert from armed terrorist groups all the more urgent. This policy is generous and includes safe housing, food and counselling. Since the beginning of my administration, 2,215 FARC, ELN and "self-defence" (paramilitary) members have laid down their arms. I have instructed my advisers to include child rehabilitation in the agenda of the meeting on international support for Colombia that will take place in Europe soon.

This government's democratic security policy aims at guaranteeing human rights to everyone in Colombia. Homicides and kidnappings have diminished by 23% and 32%, respectively during the first eight months of 2003. We do not feel satisfied with our results so far and we will persevere in our efforts to secure our aim. All constructive and balanced criticism from NGOs is welcome and we respect the right of all NGOs to have their say, even if negative. However, we reserve the right to disagree with those reports which make claims without documentation or distort facts and achievements.

The armed terrorist groups will continue to ignore international opinion. They survive despite increasingly successful pressure from the state because of their revenues from the international drug trade. We are grateful for the support that we already receive but we need even greater international co-operation to disrupt the drug trade, reduce consumption, seize assets that are held outside Colombia and restrict the supply of arms to these groups.

Alvaro Uribe Vélez
President of the Republic of Colombia
Bogota

## Cancún cannot

SIR – The question of the reduction of agricultural subsidies is represented as a conflict between the developed and developing countries ("Cancún's charming outcome", September 20th). The rich are enjoined to sacrifice some of their advantages for the benefit of the poor. But it is certainly not to my advantage, living in a rich country, that large amounts of my money should be paid in subsidies to those farmers large enough to be exporters. Hence, the conflict is between large farmers in rich countries—necessarily a very small minority—and the rest of the world. Expressed like this, it is hard to understand why there is any doubt about the outcome.

The problem seems to be that agriculture ministers are invariably on the side of producers, to the detriment of consumers, and that subsidies are not perceived by the public for what they are: a direct charge on their pockets.

Michael Scott
Hammersbach, Germany

SIR – You say that no country should have objected rationally to putting trade facilitation on the table of the WTO negotiations, given the fact that complex, inefficient and corrupt customs procedures make up a big share of trade transaction costs, which are many times higher than tariffs. Yet reason played little role in the progress of the talks at Cancún.

We have developed and promoted trade-facilitation standards and measures for more than 40 years. In the period between Doha and Cancún we held two international forums at which everyone agreed on the potential benefits for all from trade facilitation. A predictable multilateral regime of trade facilitation can produce tangible benefits for all countries and companies regardless of size or cultural difference. It is an opportunity missed.

Carol Cosgrove-Sacks
United Nations Economic Commission for Europe
Geneva

## Pointing the finger

SIR – It is of great disappointment that a respectable publication would show such bad taste and poor judgment in displaying a "finger" on the cover (September 20th). I feel ashamed to show this particular issue to my teenager son. *The Economist* owes its readers an apology.

B. Chan
Toronto

SIR – Whoever made the final decision to go with the finger on your cover merits the US Medal of Freedom, our highest civilian honour. This picture says far more than a thousand words. And thanks for the new screen saver.

Mike Todaro
Atlanta

SIR – I object to the image of a cactus in the shape of an obscene gesture of American origin. I realise that you admire all things American but what is wrong with the good old British V-sign?

Patrick Jehu
Thorverton, Devon

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Iraq's weapons

# The more deceived?

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AP

**Tony Blair and George Bush exaggerated the threat of Saddam Hussein's weapons**

PATIENCE is a special virtue if you are searching for weapons of mass destruction (WMD) in Iraq. For months, Tony Blair and George Bush have urged the world to wait for the findings of their weapons sleuths before accusing them of making a dishonest case for ousting Saddam Hussein. That team, it now seems, has found, well, not much. No matter, some British and American officials imply: the war is won, and there are bigger things to worry about. They are wrong: on the vindication of the pre-war claims about Iraq's illegal arsenal hangs public trust in government; the practicality of the doctrine of pre-emptive war; and much besides.

Since Baghdad fell, both leaders have faced vitriolic but limited skirmishes over Iraq's WMD. George Bush was harangued over the line, in his state-of-the-union address, about Iraq trying to buy uranium from Africa, after it emerged that some of the documents that purportedly substantiated this claim were fake. Similar uranium charges were levelled by Colin Powell, Donald Rumsfeld, Paul Wolfowitz and Condoleezza Rice, all members of the president's national-security inner circle. Mr Bush attributed the allegation to Britain's intelligence service, which still stands by it; but it turned out that the CIA had asked the White House to excise it from another presidential speech in October 2002. The affair blew over, but it left an impression of (at best) officials failing to communicate properly with each other and with allies.

Mr Blair's troubles have seemed more acute—partly because the war was less popular in Britain than in America, and partly because of the suicide of David Kelly, a government weapons expert. He was a source for a controversial story on BBC radio that alleged the British government had “sexed-up” a dossier it published last September, detailing Iraq's weapons capabilities. In particular, Alastair Campbell, then Mr Blair's top spin-doctor, stood accused of inserting into the dossier the notion that Iraq's “military planning allows for some of the WMD to be ready within 45 minutes of an order to use them”. The government set up an inquiry, ostensibly to look into the circumstances surrounding Mr Kelly's death.

The 45-minute claim has been Mr Blair's equivalent of Mr Bush's uranium trauma, only more so. It is an odd sticking-point, since if Iraq possessed WMD—actual weapons, and not just the means to make them—it ought to have been able to deploy them swiftly, as it did in the 1980s. Mr Blair, testifying to the inquiry, said that, if he thought the government had lied to the public, he would have resigned. No evidence of outright lying has come to light, and the spy chief nominally in charge of compiling the dossier insisted that the buck had stopped with him. But the inquiry has revealed some fishy goings-on.

## Killer facts

For instance, one of Mr Blair's most senior aides observed in an e-mail that “The dossier does nothing to demonstrate a threat, let alone an imminent threat.” Yet in his foreword to the published version, Mr Blair described the threat as “serious and current”, arguably equally alarming adjectives. Just before publication, the same aide successfully requested that a sentence predicting Mr Hussein would use his WMD *if threatened* be changed to reflect a vaguer danger. The weapons that were allegedly good-to-go within 45 minutes, it turns out, were battlefield munitions—nasty, but much less worrisome than the longer-range missiles that were conjured up by the ensuing newspaper headlines, such as “Brits 45 minutes from Doom” (the *Sun*). The government did nothing to correct such misreadings.

And the inquiry confirmed that the 45-minute factlet—also deployed by Mr Bush—derived from a single, uncorroborated source, who had himself picked it up from an Iraqi officer. A committee of British MPs concluded that, given this provenance, the government ought not to have given the claim such prominence in the dossier. Mr Campbell urged that some of the document's language be tightened—for instance, successfully arguing that the word “may” be jettisoned in a passage about the 45-minute capability. Some experts, it emerged, were concerned over the certainty the dossier evinced, particularly the notion that Iraq had continued to produce chemical weapons. Their political and spy masters seem to have tried to cover up those concerns. The inquiry's report will be published later this year.

Other participants in and supporters of the invasion have been under pressure too. In Spain, where the war was even more unpopular than it was in Britain, José Maria Aznar's government has been accused of exaggerating the Iraqi threat, and of telling senior military officers what to say about it. In Australia, an intelligence analyst has accused the government of dishonesty—strenuously denied by John Howard, the prime minister.

So not only Mr Blair and Mr Bush will have had hopes pinned on the interim findings due to be presented to Congress by David Kay, leader of their inspection team, as *The Economist* went to press. Alas, he seemed unlikely to pacify the sceptics. He is said to have uncovered some details of the Iraqi concealment effort, and some documentary proof that Mr Hussein was thinking about resuming WMD manufacture, especially biological weapons. There may also be news about Iraq's efforts to extend, illegally, the range of its missiles.

But Mr Blair and Mr Bush did not just claim that Mr Hussein intended to make illegal weapons, nor just that he had the kit to do it, but that he had retained stocks of the things themselves. They clearly believed this, as did their spies. The fact that British and American soldiers went into battle encumbered by those sweaty chemical-protection suits is proof of that. Independent think-tanks, such as the International Institute for Strategic Studies, which produced an influential assessment of the Iraqi threat before the war, also believed that the WMD threat was real.

Mr Kay may yet find such weapons, and extricate the two leaders from the Scud-shaped hole in which their pre-war warnings have landed them: London and Washington are both stressing that he has many more months, and possibly years, of sleuthing still to do. But his findings (or lack of them) suggest that the uranium farrago and the messy genesis of the 45-minute claim were part of a broader sloppiness in making the case for war.

## Lest we forget

Critics of the war ought to remember that, quite apart from the guesstimates of spies, there was ample evidence that Mr Hussein was up to no good. Some of it came from UNSCOM, the UN inspection team during the 1990s, which, thanks in part to high-level defections, uncovered among other things a biological-weapons programme that Iraq had concealed. Discrepancies in Iraqi record-keeping, lies and Mr Hussein's determination to thwart them made it impossible for UNMOVIC, the latter-day inspection body led by Hans Blix, to be sure how much illegal ordnance Iraq possessed, and what deadly agents—if any—it had retained to put in them. But on the eve of the war, UNMOVIC reported a “strong presumption” that around 10,000 litres of Iraqi anthrax might still exist.

Then there was Mr Hussein's indisputable record of making and using WMD. The idea that he voluntarily disposed of all his illegal gear between 1998 (when UNSCOM left Iraq), and 2002 (when UNMOVIC arrived), having gone to such lengths, and submitted his

AP

country to such hardship, in order to retain them, seemed incredible. It still does.

**Seeking here**

The trouble—from Mr Bush's and Mr Blair's point of view—was that the UN inspectors' findings, though alarming for anyone with the stamina to digest them, were complicated and circumstantial. So they added some less nuanced and more blood-curdling accusations of their own.

In February, Colin Powell, Mr Bush's secretary of state, told the UN that biological warheads had been distributed across western Iraq. He also talked at length about a putative connection between Iraq and al-Qaeda, and estimated that Iraq still had a few dozen Scud missiles. In the October speech from which the uranium allegation was dropped, Mr Bush said that “Iraq has a growing fleet of manned and unmanned aerial vehicles that could be used to disperse chemical or biological weapons...We're concerned that Iraq is exploring ways of using these UAVS for missions targeting the United States.” In his state-of-the-union address, he said that Iraq had “upwards of 30,000 munitions capable of delivering chemical agents”. Announcing the start of the war, Mr Bush said America would “not live at the mercy of an outlaw regime that threatens the peace with weapons of mass murder.”

## Pull the other one

The al-Qaeda link always looked thin, and has received little corroboration in Iraq or from captured terrorists. Ansar al-Islam, an Islamist group fingered by Mr Powell as proof of the link, operated in a part of Iraq that was outside Mr Hussein's control. British intelligence, it has emerged, gave warning that the threat from al-Qaeda could be heightened by an attack on Iraq, as could the risk that Iraqi WMD would fall into terrorist hands. The CIA once held a similar view. Mr Bush recently conceded that, contrary to many Americans' beliefs, there was no evidence to link Mr Hussein to September 11th.

In retrospect, the next weakest part of the case concerned Iraq's nuclear efforts. Here the Americans were especially cavalier. Mr Bush argued that Mr Hussein was actively pursuing nuclear weapons. Along with the uranium accusation, an important plank in this theory was Iraq's efforts to import aluminium tubes: Mr Bush and Mr Powell alleged that these were intended for use in the production of bomb-grade uranium. Yet the IAEA (the international nuclear inspectorate) disagreed—as, it has since emerged, did some agencies within the American government, including Mr Powell's own intelligence unit. Mr Powell confessed that there were two opinions on this, but plumped for the more sinister one.

Mr Hussein certainly had a well-hidden and scarily advanced nuclear programme before the 1991 war. He retained a cadre of nuclear scientists, and was acquiring other kit that might have had nuclear applications. But there appears to have been little fresh evidence to justify the apocalyptic talk with which American officials attempted to daunt and galvanise the public. “We don't want the smoking gun to be a mushroom cloud,” said Ms Rice, the president's national security adviser, and the image was also used by her boss. The best guess of American spies was that Mr Hussein would not have a nuclear bomb until 2007 or 2009. Both the Americans and the Brits predicted that he could get one sooner if he obtained fissile material from abroad—a big if.

All this was not merely the icing on the UNMOVIC cake: these allegations helped to make the threat seem imminent—or, if you prefer, “serious and current”. None of them has been substantiated. Some chemical-protection gear was seized in Iraq during the war, and some very old nuclear documents and parts were dug up in an Iraqi scientist's garden. But inspectors who visited the sites mentioned in the British dossier and Mr Powell's presentation as WMD facilities found nothing incriminating. America once seemed confident that it had seized two mobile biological-weapons facilities, like the ones Mr Powell described at the UN. But outside (and some inside) experts disputed this analysis, and they are no longer much talked about.

## Fools or knaves?

So: no stocks of chemical shells, no Scuds, no illegal UAVS. This has astonished even doveish doubters.

At the very least, the weapons that were thought to have been deployed to the battlefield should have turned up. But they haven't. Mr Bush and others have conjectured that Mr Hussein may have destroyed his illegal munitions on the eve of war, or sunk them in the Tigris and Euphrates (an odd move, if true). But if this had happened on a large scale, and the ISG knew where, they might well have found some traces. They haven't.

Why? A number of excuses have been advanced. Iraq is a big country, and Mr Hussein was very good at hiding things. Valuable paper trails have been erased by looting. Some of the weapons kit can be used to make other, innocent things, and, once scrubbed-up, can be hard to identify for certain. Iraqi WMD experts are still too scared of the Saddamites to spill the beans—though many of them have now been in custody for months. The weapons programmes were dismantled and dispersed to hide them from the inspectors—though that would suggest a containment strategy might not have been quite so untenable after all. Some still suspect that illicit material may have been smuggled out of the country, perhaps to Syria.

The line in Washington is that the team first assigned to the WMD hunt spent its time vainly searching suspect sites rather than interrogating scientists and henchmen—though, at the time, they were said to be doing a fine job. An incentive scheme to encourage bean-spilling is now in place (though the imprisonment of some Iraqi scientists may have discouraged others from coming forward). Others may co-operate if Mr Hussein is nabbed or killed.

AP

**Seeking there**

The simplest explanation is, of course, that Iraq had destroyed its WMD, and that the British and American intelligence services—and, it must be said, others who largely agreed with them, even if their governments did not advertise the fact—got it badly wrong. Even if more compelling discoveries are made in Iraq, it is too late for the spooks to be wholly vindicated. But their political bosses also have questions to answer about the way they used or abused the intelligence.

For instance: why did Mr Bush and Mr Blair often omit the caveats and subjunctives with which the spies hedged their judgments, as is clear from the little intelligence material that has been declassified? And how much fresh data did Britain and America really get from inside Iraq after the UNSCOM inspectors left in 1998? If it wasn't much, why did the politicians give the impression that it was? The datedness of the Iraq intelligence was one of the main anxieties expressed in a letter reportedly sent by the heads of a congressional intelligence committee to the CIA last week. “Lack of specific intelligence”, they reportedly wrote, “appears to have hampered the [intelligence community's] ability to provide a better assessment to policymakers from 1998 through 2003.”

Contradictory answers to this question have been given by Mr Rumsfeld, Mr Bush's defence secretary, who said that old data came to look different after September 11th, and by George Tenet, the CIA chief, who says that there were indeed newer sources. If there weren't any or many, did analysts and their masters extrapolate from what they knew, or thought they knew, and present the outcome as fact? Did the two governments “cherry-pick” the most gloomy assessments and prognoses? The underestimation of Iraq's nuclear progress before 1991 would have encouraged such an approach, and the aluminium-tube affair suggests that it was adopted. As late as February of 2001, Mr Powell believed that Mr Hussein “had not developed any significant capability with respect to weapons of mass destruction.” Something happened to change his mind.

And how much weight was given to the testimony of defectors, often eager to please, and (still less reliably) to exiles, who are often out of touch with their native lands, and busily grinding private axes? Their influence seems to explain, in part, why some Americans expected ordinary Iraqis to be throwing flowers at their occupiers. A leak from the Pentagon's Defence Intelligence Agency reportedly suggests that information from defectors furnished by the Iraqi National Congress turns out to have been distinctly suspect. Was there a kind of un-virtuous competition among the various American agencies, with some trying to outdo others by furnishing the administration with evidence that most suited its prejudices?

Mr Bush and Mr Blair could have erected a strong case purely on the UN reports and Mr Hussein's atrocious record. But they didn't. They probably expected the sceptics to be quietened and chastened by the use of WMD during the war. But such weapons were never unleashed. Now they face a variety of congressional and other probes into their case for toppling Mr Hussein. One British committee has already complained that too much “intelligence” has been withheld for it to reach properly informed

conclusions. If that continues, it will be impossible to tell whether Mr Bush and Mr Blair or their publics were the more deceived.

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California

# Engine trouble

Oct 2nd 2003 | LOS ANGELES
From The Economist print edition

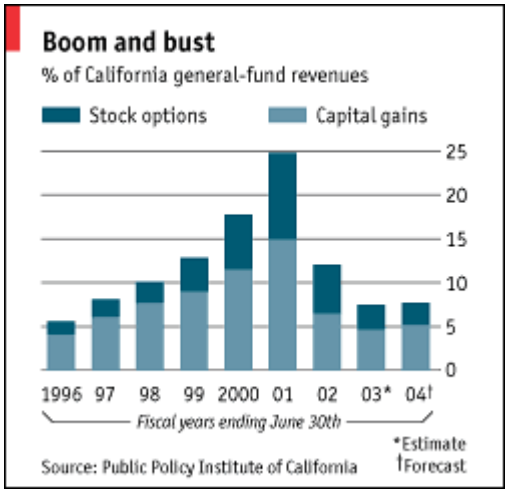
Getty Images

**As Californians go to the polls, we investigate the condition of America's most dynamic and most troubled state**

OUTSIDERS may well wonder what on earth is going on. Californians are about to decide, in a costly special election on October 7th, whether to recall (ie, sack) their Democratic governor, Gray Davis, less than a year after granting him a second four-year term of office. Moreover, if a smidgeon more than 50% give Mr Davis the thumbs down, his replacement, since there are 135 names on the second part of the ballot paper, could be someone with a much smaller share of the vote and zero experience of practical politics. So much for representative democracy in America's richest, most populous state.

No matter, say proponents of the recall. The state will be much better off without Mr Davis. Arnold Schwarzenegger, the Republican muscleman-turned-movie-star who is best placed to fill the governor's chair, pounds home the message: economic mismanagement by Mr Davis and his cronies in Sacramento have turned a state budget surplus of $12 billion in 1998 into a potential deficit for the 2003-04 tax year that began in July of $38.2 billion.

A failure to accept that the dotcom bubble would inevitably burst meant that when tax revenue for stock options and capital gains fell abruptly by half in 2001-02 (see chart), state spending carried on regardless. Only a belated mix of spending cuts, bond issues and optimistic accounting has allowed the balancing of this year's budget of some $96.4 billion—and the government admits that a "structural deficit" of some $8 billion is likely to resurface in a year's time.




No wonder, then, that many of California's top businessmen last week told Governor Davis, in a full-page "open letter" in the state's five largest newspapers, how deeply California was in trouble and how many jobs—more than 300,000 high-wage manufacturing jobs in less than three years—had disappeared, many to neighbouring states such as Arizona, Utah and Nevada. In theory, the letter was addressed not just to the governor but also to his potential replacements and to the present legislature. In practice, it looked suspiciously like an endorsement of either Mr Schwarzenegger or Tom McClintock, the tax-cutting conservative state senator who is now his only Republican rival.

There is, however, an equally obvious explanation for Mr Davis's plight. Californians have become powerfully addicted to direct democracy: initiatives, which allow voters to pass their own ideas, or “propositions”, directly into law; referendums, by which they can support or kill decisions from the legislature in Sacramento; and recall elections. Such measures are not unique to California (18 states have recall provisions, with North Dakota, in 1921, being the first—and so far only—one to recall its governor), but no state has used them so energetically. Since 1980 the electorate has been asked to vote on over 120 statewide initiatives, of which more than 50 have passed into law.

## Proposition 13's legacy

Alas, California is not, or not yet, Switzerland: too often the voters' direct democracy has meant politically impossible fiscal arithmetic for their elected representatives, including the hapless Mr Davis. Consider, in particular, Proposition 13, a citizens' initiative put on the 1978 ballot by Howard Jarvis, an anti-tax crusader in Los Angeles. It aimed to reduce property assessments to the levels of 1975-76; limit the tax rate to 1% of the purchase price; and restrict the increase in valuations to 2% a year until the next sale of the property. At a stroke, every homeowner, from working-class Latinos in Compton to film stars in Bel Air and Beverly Hills, would benefit handsomely. Moreover, to make sure the benefit would last, Mr Jarvis proposed that a two-thirds vote by state and local legislatures would be needed to approve any new taxes. Despite dire warnings from officialdom, both state and local, Proposition 13 passed with 65% of the vote.

Now consider the repercussions. Because local governments can no longer so easily tap property-owners, they are more dependent on the state government—which in bad times, such as the recession of the early 1990s or the downturn of today, has to cut back on its generosity. The results are increasingly obvious: ill-maintained highways and a deteriorating public-school system, in which only 30% of seventh-grade pupils meet the state's levels for mathematics and language proficiency. According to Stephen Levy of the Centre for Continuing Study of the California Economy, in Palo Alto, California now comes 30th among the states in spending on pre-college education, and among the bottom fifth on most measures of infrastructure investment.

Such citizens' initiatives make it difficult to plan properly for the overall economy. Proposition 98, passed in 1988, requires that a minimum of 40% of the general fund (which represents four-fifths of the total state budget) be spent on primary and secondary schooling; Proposition 42, passed last year, dedicates the sales tax on petrol to transport projects. Add such initiatives together, and around 70% of the general fund is off-limits to the politicians.

Yet voters persist in their addiction, with Mr Schwarzenegger's approval. When Warren Buffett, the stockmarket guru who volunteered to be his economic counsellor, suggested that low property taxes were a cause of the state's problems, Arnie smartly told him to forget messing with Proposition 13 and to do 500 sit-ups as a punishment. As Mr Schwarzenegger well understands, the voters do not trust the political establishment.

That is why in 1990 they passed Proposition 140, limiting the governor and the 40 state senators to two four-year terms in office and the 80 assemblymen to three two-year terms. It is also why they blame the politicians, and Mr Davis in particular, for the present economic mess: the budget deficit, high energy costs (remember the rolling electricity blackouts of 2001) and unemployment at 6.6% of the workforce.

But how bad is that mess? The open letter bluntly talked of “economic ruin” ahead. The Milken Institute, based in Santa Monica, reckons that manufacturing costs are 32% higher than the national average. Washington's Tax Foundation ranks California 49th out of the 50 states in its “business tax-climate index”, which takes account of personal, corporate and sales taxes, plus the complexity of the system. Apparently, only Mississippi has a more unfriendly tax climate for business.

As for individuals, their “Tax Freedom Day”—the foundation's witty notion of when a person will have earned enough to pay off his total annual tax bill—comes on April 29th, ten days later than the national average and later than all states except New York, Connecticut and Massachusetts. Moreover, the system for personal income tax is one of the most progressive in America, with a top bracket that begins at a modest $38,291. For a Californian with $40,000 of taxable income, the 9.3% state tax is the highest in the country.

Reuters

## A bit of perspective

Yet, if California is in a mess, so is the rest of America. Look beyond the campaign rhetoric, and the picture is rather more nuanced. As Mr Levy points out, California's problems mirror those of the American economy as a whole. Over the three years since the end of the dotcom boom, both the state and the nation have lost around 15% of their manufacturing jobs, including an identical 25% loss in high-tech work. Compare Silicon Valley, which lost 29% of its computer and electronic manufacturing jobs between May 2000 and May 2003, with Austin, Texas: Austin's loss was 32%. Hewlett-Packard's Carly Fiorina may complain about the loss of jobs, but she shares some of the responsibility: HP's merger last year with Compaq of Houston meant the shedding of nearly 18,000 jobs, many of them in California.

**Goodbye, Gray?**

In other words, why blame Mr Davis and the other supposed incompetents in Sacramento? The true power to stimulate a weak economy lies with the Federal Reserve and the federal government. California's economic indicators almost always match national trends, and there has never been an economic upturn in California separate from a national recovery. The real problem, therefore, is that the present national recovery is uniquely jobless: in all previous recoveries since the second world war, job levels were higher within 20 months of the end of the recession. This time they are lower, as President George Bush is uncomfortably aware.

On the other hand, why not blame Governor Davis? His Republican predecessor, Pete Wilson, was similarly unpopular during the 1991 recession, when the aerospace and defence industries collapsed, and he helped to destroy his party by embracing anti-immigrant policies in 1994; but he at least had the force of character and the political skills to pass the budget by pushing through higher taxes and lower spending. He also coped admirably with the 1994 Northridge earthquake.

In contrast, Mr Davis dithered when faced with the electricity crisis of 2000-01 and has singularly failed to control the legislature (“He's ceded it to the far left of the Democratic Party,” says one complainer). Another astute political analyst, Sherry Jeffe, notes: “He's such a cautious politician that when he faces a difficult situation, he freezes. Pete Wilson never froze.”

To this must be added Mr Davis's willingness to favour special interests, be they prison guards, teachers, Indian tribes or Latinos. There is a widespread perception that he and the Democratic-dominated legislature have allowed California's problems to balloon because they are more interested in doing favours to their campaign contributors than they are in good government; and since California is, in effect, a one-party state, no opposition checks them. In a recent poll by the independent Public Policy Institute of California (PPIC) Mr Davis's approval ratings ranged miserably between 23% and 31%, depending on the question.

His position now looks pretty dreadful, and Arnie's increasingly good. Mr Davis has a big war-chest and a proven ability to play political hardball, but such tactics have appalled even his supposed Democratic allies. Late in July, for example, the state's attorney-general, Bill Lockyer, warned Mr Davis that everyone had had enough of his “puke politics”. The last straw breaking the governor's back is probably the increase in the vehicle-registration fee, introduced as a desperate ploy to balance the budget; Californians, who live in their cars and often have several, must pay the extra cash this week.

Mr Davis may hope to gain a respite because of the changing profile of Californians themselves. The state is the first on the American mainland in which no ethnic group has an absolute majority: of its 35m residents, 47% are non-Hispanic whites; 32% are Hispanic; 11% Asian and Pacific Islanders; 7% black; and 1% American Indian. Mark Baldassare, the PPIC's research director, points out that among registered voters 45% of California's whites are Republicans, 39% are Democratic and 16% are independents. An overwhelming 59% of its Latinos and 78% of its blacks are Democrats, the Republican Party having cavalierly thrown away Latino support. But Latinos vote far less than whites—not least because they are generally younger, and nearly half of adult Californians under the age of 25, it seems, have little or no interest in politics.

Independents and Latinos may therefore hold the balance in this election. Gray Davis and Cruz Bustamante, the Democratic lieutenant-governor who theoretically opposes the recall but still offers himself as Mr Davis's successor, will need their support to combat white Republicans and disaffected white Democrats; Arnold Schwarzenegger will need them because too many of his party's conservative faithful judge him “Republican-lite”.

All of which adds up to an unseemly contest for the Latino vote. Mr Bustamante can hardly make a speech without mentioning his dirt-poor origins as the grandson of hardworking Latino immigrants. Mr Schwarzenegger turned up at a citizenship ceremony and stressed that he, too, was once a poor immigrant doing manual labour. Most blatantly, Mr Davis signed a bill which will allow “undocumented” immigrants, most of them from Mexico and Latin America, to have driving licences—a move that Mr Bustamante supports on the ground that such illegal residents do the work that “white Anglos” will not, pay their taxes, and are anyway often driving cars, but without insurance.

Yet, ironically, the driving-licence issue may well be the single most important factor in evicting Mr Davis from the governor's mansion. One reason is the governor's overt cynicism: two years ago he had dismissed the idea, claiming it was a risk to national security. A second reason is the widespread view that that risk to national security is, indeed, real—though one presumes that any competent terrorist would have decent documents anyway.

The third reason is that there are plenty of white Californians, Republican or not, who feel immigrants deserve no special favours. That is why in 1994 they voted overwhelmingly for Proposition 187, stopping public services to illegal immigrants (most of the measures were later declared unconstitutional); in 1996 for Proposition 209, against affirmative action; and in 1998 for Proposition 227, against bilingual education. Only next week's Proposition 54, which would bar the state from collecting race-based data (see article), seems likely to buck the trend and fail.

Would a defeat for Mr Davis mean a resurgence for the state Republicans, who in last year's elections failed to gain a single office in the Sacramento government? In the short run, maybe. But, in the long run, only if the Republicans can woo the Latinos away from the Democrats. After all, if the demographers are right, within 20 years California's Latinos will outnumber non-Hispanic whites. And meanwhile there will surely be dozens of citizens' initiatives to complicate both parties' lives.

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**Affirmative action**

# Moving on, but very slowly

Oct 2nd 2003 | WASHINGTON, DC
From The Economist print edition

**After racial preferences come “racial privacy” and “economic diversity”**

Get article background

CALIFORNIA'S much-tried voters have another choice to make on October 7th. They are invited to vote on Proposition 54, which would ban the state from putting its citizens into racial boxes in everything from education to hiring and contracting. The initiative follows a successful proposition in 1996, when Californians voted to ban affirmative action in state activities. Like that one, the current “Racial Privacy Initiative”, as it is called, is sponsored by Ward Connerly, a long-time foe of affirmative action who has made a name for himself by taking his fight against racial preferences directly to the people.

So far, most opinion polls show voters fairly indifferent to the initiative—those, that is, who are aware of it at all. A recent poll, interestingly, shows support running strongest among Latinos and Asian-Americans, followed by blacks, with whites liking it least. Opponents have launched a TV campaign to persuade voters that the initiative would hinder public-health efforts, which sometimes track diseases by race, even though it provides an exemption, at least on its face, for medical research.

AP

**Michigan's victims**

The vote on Proposition 54 is the first test of public feeling about racial preferences since the Supreme Court ruling in two cases concerning the University of Michigan. According to that ruling, assigning points to applicants by skin colour (as Michigan's undergraduate college had done, thereby passing over better-qualified white applicants) is forbidden under the constitution. But Michigan's law school, said the court in a rush of New Age jargon, was within its rights to take account of race as part of a “holistic” and “individualised” admissions process. In short, crass “mechanical” devices such as quotas are not allowed; but race may be considered as one factor among others.

So what comes next in the debate over racial preferences? The court's ruling did little to clarify matters. So far, only a handful of universities have changed their admissions policies, so most racial-preference schemes will continue unchanged. In some states, however, such as California and Texas, local policies are still in place that prohibit racial preferences in university admissions.

In Texas, for example, a scheme that admits the top 10% of graduates from every high school in the state, regardless of race, still stands. The state legislature can change this; but so far it has shown no sign of doing so. For the state's graduate schools, however, the situation is different. With many fewer places available, and with an intake from all over the country, they would like to take account of race, but so far have made no moves to do so.

Although the Michigan decisions seem to have made racial preferences safe in American universities, opponents vow to keep fighting in the courts. Curt Levey of the Centre for Individual Rights, a civil-rights law firm which brought the Michigan cases, vows that his firm will monitor the ban on the “mechanical” preferences used by the Michigan undergraduate programme. Damages are yet to be awarded to the plaintiffs who were unfairly denied a place. His firm is also compiling a list of wrongs to use in suits against other universities. Lawyers will be busy for years.

Elsewhere, notably in racial preferences used in employment and government contracting, the tide

continues to run against race-based solutions. Last month, in Boston, a city that has seen some of America's worst racial conflicts, a federal judge awarded damages to white applicants seeking jobs in the fire department, ruling that they been harmed by the city's 30-year-old racial hiring quotas. The whites had received higher scores on civil-service exams, but had been passed over in favour of minority applicants. The court's ruling minced no words: affirmative action had “outlived its usefulness”, since the fire department now has a slightly higher proportion of minorities than the Boston population as a whole.

Mr Levey has also filed suit against the federal government's Department of Housing and Urban Development, alleging that a St Louis project manager had been similarly mistreated. He is aiming to chip away further at rules that give preference to minority-owned businesses in federal contracting.

America's universities will probably be immune from such pressure for a long time to come. But another form of preference may be poised for rapid growth: so-called “economic diversity”. When the University of Michigan revised its admissions process in August to conform to the Supreme Court's ruling, it hinted at a new emphasis on the class background of its applicants. Yet that sort of preference may be much harder for top schools to organise. Although America's best universities are loth to disclose the income of their students, the better-off undoubtedly predominate—not least because the sons and daughters of high-earning alumni are regularly preferred.

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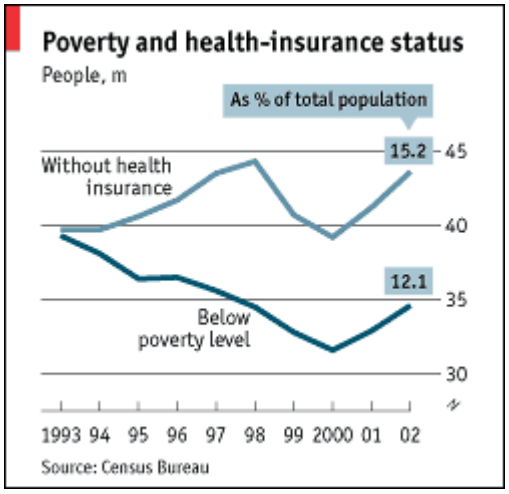
The economy

# Life's getting tougher

Oct 2nd 2003 | WASHINGTON, DC
From The Economist print edition

## Discouraging figures from the Census Bureau

Get article background




POVERTY has grown worse, median household incomes are falling, the number of Americans without health insurance is soaring. Those are the grim highlights of a batch of statistics released in the past week by the Census Bureau. Most startling were the health-insurance figures. In 2002, the number of Americans without health insurance rose by 5.7% to 43.6m, the biggest single-year increase in a decade. The combination of a jobless recovery and rising health-insurance premiums meant that the percentage of people receiving health insurance through their employers fell from 62.6% in 2001 to 61.3% in 2002.

Median household cash income fell for the third year running in 2002, to $42,409, while America's official poverty rate—defined as an income below $18,392 for a family of four—rose for the second year in a row. The poverty rate climbed from 11.7% to 12.1%, as 1.7m more people fell below the poverty line. According to the official measure, which counts pre-tax cash income, 34.6m people live in poverty in America.

These figures are grim, but they need to be put into context. Though higher than it was at the height of the recent economic boom, America's poverty rate is still below the average of the past two decades. Broader measures of poverty and income—which look at post-tax income and include the value of non-cash benefits, such as food stamps—also paint a more nuanced picture. Although poverty rates in the six alternative measures tracked by the Census Bureau are slightly higher than the official rate, they were broadly unchanged in 2002.

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Arab-Americans

# That patronising tone

Oct 2nd 2003 | DETROIT
From The Economist print edition

**Colin Powell's vision of America as liberator fails to impress**

IT IS almost 20 years since Walter Mondale, then the Democratic candidate for president, gave back campaign contributions from Arab-Americans because he was afraid of putting off Jewish voters. Mr Mondale lost the 1984 election anyway, and since then Arab-Americans, a pretty mixed lot, have remained in the shadow of better-organised minority groups. Now, in a changed world, they are trying to pull themselves together. Their number (nearly 4m on some counts), and what they could do for American policy in the Middle East, make them an attractive target for both the big political parties.

Alas for the Republicans, they missed their target on September 29th, when Colin Powell, the usually persuasive secretary of state, spoke to the US-Arab Economic Forum in Detroit. Before Mr Powell arrived, the conference—attended by nearly 1,000 people from three dozen countries, including crown princes, sheikhs, government officials and senior executives—had concentrated on trade, technology and education. Little was said about the fingerprinting and intense questioning some of the visitors had gone through on their arrival in America.

It was a splash of cold water, then, when Mr Powell insisted on talking about Iraq, the Arab-Israeli conflict and Iran's ambitions for nuclear weapons in the most self-righteous tones. (“Our tradition,” he said, “is that of liberation, not occupation.”) He set out what the administration hopes to achieve in the Middle East, and asked for Arab help. Nothing new in this; but his bursting of the smooth bubble irritated many of those present.

“It was disappointing, condescending, preachy and one-sided,” said a leading Arab-American businessman. Others in the audience were irritated by Mr Powell's suggestion that the Middle East “road map” had been hijacked by Arab terrorists (though he was clapped for saying that Israel should end the settlements). A couple of brave souls who stood up to applaud after Mr Powell's remarks promptly sat down again on realising they were alone in the massive ballroom.

In contrast Amre Moussa, the secretary-general of the Arab League, and Prince Saud al-Faisal, the Saudi foreign minister, both made warmly received speeches admitting to problems in the Arab world but urging America to let Arabs decide how to solve them. Even some of the conference's organisers criticised Mr Powell. “Arab-Americans were not asked to be included” in shaping policy on Iraq, said Ahmad Chebbani, chairman of the American-Arab Chamber of Commerce. “Now they need us to participate financially? The message [from Mr Powell] seemed to be, ‘Help us out'.”

This comes at a bad time for the Bush administration. The Arab-American vote, strong in key states such as California and Michigan, could be important in next year's presidential election. Although they have not been polled recently, past opinion polls have showed George Bush's one-time popularity falling among Arab-Americans since the passage of the Patriot Act, which led to the detention or deportation of many Muslims, and America's foray into Iraq. Meanwhile, according to a government report released on October 1st, hostility to America in the Arab world in general has “reached shocking levels”.

Some of the would-be Democratic presidential candidates will try to woo Arab-American voters at a meeting later this month. They will be encouraged by the views of many present on September 29th, as the ground was broken for the country's first Arab-American museum in the suburb of Dearborn. A middle-aged woman in traditional headscarf, lamenting the growing unemployment among Arab-Americans, said she would vote for “anyone but Bush”. She is not alone. One Democratic hopeful, Howard Dean, the ex-governor of Vermont, has attracted the interest of many Arab-Americans by calling on America to be more impartial in the Israeli-Palestinian conflict.

Still, a few Arab-Americans did come to George Bush's defence this week. Nafa Kalaf Al Janabie, an Iraqi-American praised by Mr Powell, is the president of Detroit Contracting, a waste-water treatment company that recently opened an office in Baghdad, where it hopes to benefit from American and United Nations contracts. “We've got to build on the positive and eliminate the negative,” said Mr Janabie. Just the sort of man Mr Bush needs in Baghdad—and at home.

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The National Guard

# Overstretched and over there

Oct 2nd 2003 | MIAMI
From The Economist print edition

**Part-time soldiers have to go to Iraq, too**

NOT since the Vietnam war have the families of American servicemen expressed such deep disquiet. At a Senate Appropriations Committee hearing on September 24th, members from many different parts of the country raised questions about the demands now being placed on the National Guard and the Reserve—the part-time soldiers, usually deployed for maintenance, transport and logistics, who are now being sent to Iraq.

Famiies and congressmen are upset by a new Defence Department policy that has extended the overseas missions of reservists and the National Guard in Iraq to at least a year, far longer than they are used to. Worse still, the Pentagon now expects them to serve all that time in Iraq, if the commander of their unit needs them. Reserve and National Guard units traditionally spent much of their active duty on bases in the United States, being trained to go abroad. No such quiet life now. In past months, recruitment had been boosted by the lack of jobs elsewhere in the economy. Now recruiters fear it may fall again.

Reuters

**No longer just a weekend job**

Yet it also seems likely that the Pentagon will need to call on thousands more National Guard members, beyond the 20,000 already in Iraq. Regular forces in Iraq are stressed out and overstretched. The Pentagon wants to bring home the 101st Airborne, which took part in the invasion, early next year. There had been hopes that foreign help would fill the gap, of course; but that is proving very hard to find. Paul Wolfowitz, the deputy secretary of defence, told Congress last month that there were “stresses” throughout the National Guard and Reserve.

Nowhere is discontent more apparent than in Florida. The state has more National Guard soldiers activated—5,000 out of 13,000—than any other. About 1,950 Florida Guard and about 200 army reservists are stationed in Iraq, with others in Kuwait, Afghanistan and elsewhere. Most of the Iraq troops were activated in late December, but did not arrive there until March or April—and found they were placed on active duty for a year, with the possibility of a further extension.

After speaking to relatives last week at meetings in Miami, Orlando and Tampa, one Florida senator, Bill Nelson, questioned why soldiers from Florida were being made to stay longer while troops from other states have been rotated out more quickly. He had already made his case on September 10th in a letter to Donald Rumsfeld, the secretary of defence, saying “Now is the time to bring them out.”

Mr Wolfowitz has admitted that Florida's case is “extreme”. Although the biggest contingent of the National Guard comes from Alabama, Florida has more men in the front line, and they were among the first to enter Iraq alongside regular troops. Senior Pentagon officials told Mr Nelson that this was because the Florida units were “so darned good”. One of his aides attributes that to the high number of Miami police serving in the 124th Infantry Regiment, well-trained to deal with dangerous streets and hot summers.

For many others, however, Iraq is a rude awakening. In peacetime, National Guardsmen are expected to do one weekend of duty a month, as well as 15 days a year of active-duty training. Most have some active-duty military experience; some have served in Panama, Haiti or the Balkans. But none has witnessed such hostile conditions as Iraq.

Family members are anxious, however, not to appear unpatriotic. In general, they express support for the war. The mother of Sergeant Carlos Escobales, a Miami postman who was sent to Iraq in February and is now in Tikrit, had hoped he would be home in October, but had not made a fuss. Then, within hours of Mr Nelson's meetings, the Pentagon offered some good news, dusting off a “rest and recuperation” policy that has not been used since the Vietnam war. The policy allows troops with 12-month orders in Iraq to have 15 days of home leave, with special preference for those with pregnant wives and newborn children. Since Mr Escobales's wife is due to give birth to the couple's first child in late October, he will be home at mid-month after all; though he will soon be back in Tikrit again.

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Lexington

# George Bush's metamorphosis

Oct 2nd 2003
From The Economist print edition

**Kafka creeps up on the president**

ONE morning, George Bush woke up from uneasy dreams to find himself transformed into a giant insect. Well, metaphorically. The president is hardly going to be locked in his bedroom to die in misery. But he may still feel a frisson of understanding for poor Gregor Samsa, the hapless protagonist of Kafka's novella. Almost overnight, it seems, Mr Bush has been changed from the dominating commander-in-chief, forcing friends and enemies to respond to what he wants, into a man at the mercy of events, accused by almost half his countrymen of doing a bad job, and facing a metastasising scandal to boot.

As with many scandals in their early stages, uncertainties inflate speculation. Two unnamed officials in the Bush administration stand accused of leaking the name of an undercover CIA operative to the press. If they did, this was seriously sleazy. Another unnamed White House official criticised their alleged action, also to the press. This is the first time the famously disciplined Bush White House has been discovered leaking unfavourable information about other members of the administration. Clearly, there are signs of disarray.

But were any laws broken? That is not clear. The Justice Department is investigating. How much damage did blowing the CIA's cover do? Probably not much, was the agency's own first assessment. Who did the leaking? Mr Bush's senior adviser, Karl Rove, was mentioned but vehemently denies being involved. At the moment, it is fair to say that no one can judge the long-term political impact of the scandal: so far, nothing touches the president himself and there is no sign of a cover-up.

As for Mr Bush's opinion-poll numbers (the ones which show that almost half the population disapproves of the way he is doing his job), they are no worse than Bill Clinton's in September 1995. A third-year decline in presidential popularity is the norm, not a prediction of electoral defeat. The problem for the president is that the spy scandal tells you wider, awkward truths about his administration. These are being revealed at a time when his declining popularity is anyway making it harder for him to govern the country.

The leaking officials are said to have outed the CIA operative in order to discredit her husband, Joe Wilson, who was the diplomat sent to Niger last year to investigate claims that Saddam Hussein had tried to buy yellowcake uranium from that country. (Mr Bush erroneously included the claim in this year's state-of-the-union speech, attributing it to British intelligence.) Mr Wilson debunked the story and subsequently criticised the president's Iraq policy. The idea, peculiar as it may sound, seems to have

been that revealing his wife's identity would make his Niger job look like nepotism, and so not to be taken seriously.

As it is, the episode may end up discrediting Mr Bush because it implies that his administration has sought to suppress evidence that runs counter to its claims about Iraq's military scheming. It is anyway vulnerable to this charge. Because it is so secretive about its policymaking processes, it cannot allay suspicions that it did not give proper weight to counter-evidence.

On the day before the spy scandal broke, a letter surfaced from the two senior members of the House Permanent Select Committee on Intelligence (a bipartisan body) based on what the committee had found when combing through 19 volumes of material, much of it classified. The two members concluded that intelligence about Iraq was patchy and that little new had been discovered since 1998. The Democrat said that, as a result, qualifications which should have been made about Iraq's weapons-planning were not made.

The timing of all this is doubly damaging to Mr Bush, since it has erupted just as he is trying to get Congress to stump up an extra $87 billion to pay for the Iraq venture. Here is where his declining popularity comes in.

In the opinion polls, this has been the worst period yet of Mr Bush's presidency. Poll after poll has put his rating at 50% or below. He has come near that point twice before. But on both occasions (September 2001 and January 2003) al-Qaeda's attacks and the second Iraq war immediately boosted him. Now the president has come back to earth, and landed in uncharted territory. In the past, he was able to set the country's agenda by astute use of the bully pulpit, especially through set-piece televised speeches. He then got that agenda enacted into law by ramming it through the House of Representatives on a strict party-line vote, and using his popularity to intimidate fractious senators.

## Beaming or quailing no longer

It is no longer like this. Mr Bush's last two set-piece speeches fell distinctly flat. After he announced the $87 billion programme on television, you could almost hear public confidence sighing away. When he went to the United Nations for international assistance in Iraq, his domestic audience was about as impressed as Jacques Chirac. And, without high popularity, Mr Bush cannot keep senators in line. His tough partisan approach on Capitol Hill long ago lost him any goodwill among Democrats. But now Republican senators are not afraid to cross their president, either, as happened in the Medicare debate. Mr Bush ruled Congress by fear, and the Senate no longer fears him.

This does not mean he cannot get his bidding done. Mr Clinton proved a master of Congress even when damaged by scandal. Nor does it mean that the dangers of defeat next year have increased. But Mr Bush is now at the mercy of events (and of scandals) in a way that he has not previously been. As Gregor Samsa discovered, his new body horribly constrains him. “In the end...nothing else was left to him to do since to his horror he observed that in moving backwards, he could not even control the direction he took; and so...he began to turn around as quickly as he could, which was in reality very slowly.”

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GM crops in Brazil

# An amber light for agri-business

Oct 2nd 2003 | SÃO PAULO
From The Economist print edition

Getty Images

**Brazilian farmers will embrace genetically modified crops, unless European consumers pay them not to**

Get article background

JOSÉ ALENCAR, Brazil's vice-president, was feeling sorry for himself last week. His boss, Luiz Inácio Lula da Silva, was abroad, lecturing George Bush at the UN and visiting Fidel Castro in Cuba. That left Mr Alencar as the “poor wretch” with the unpleasant task of signing a decree that for the first time allows the planting of genetically engineered crops in Brazil.

The vice-president was caught between two juggernauts. One is an alliance of activists and politicians who regard biotechnology as a dangerous novelty foisted on Brazil by malign multinational companies. Many are close to President da Silva's Workers' Party, which dominates the government. The other is Brazil's increasingly powerful agri-business lobby, which sees biotech as a competitive tool. The decree—which allows the planting and sale this year of a herbicide-resistant variety of soyabean developed by Monsanto, an American company—is a victory for the planters. It will reverberate from the floor of Brazil's Congress to the shelves of European supermarkets.

In soyabeans, Brazil is a superpower (see chart). Within five years, it could become the world's biggest producer, reckons the United States' Department of Agriculture. Soya products already account for about 5% of Brazil's total exports. It has achieved this despite banning the use of genetically modified (GM) seed. That has set it apart from the United States, where 80% of the soya is GM, and Argentina, where nearly all of it is. The ban was popular not just with Lula's supporters but also with ordinary Brazilians and biotech-wary consumers in Europe.

The waiving of the ban, albeit for only one season, will shock both groups. Lula's traditional supporters are already troubled by his government's orthodox economics. They sense another betrayal. Marilena Lazzarini, head of IDEC, a consumer-advocacy group, accuses the government of succumbing to “pressure from economic interests”. Europeans, accustomed to eating GM-free food without paying much extra for it, may have to choose between their phobias and their wallets.

Farmers will cheer. In Rio Grande do Sul, a southern state, farmers have long flouted the ban, planting Monsanto seeds smuggled in from neighbouring Argentina. These require less weed killer and tillage. Brazilians get extra savings because they do not pay royalties to Monsanto for the smuggled seed. The clandestine crop already accounts for 10-20% of Brazil's total. Unbanned, Monsanto guesses that its seeds would account for 70% of soyabean production within a decade.

Brazil's treatment of GM crops has bordered on farce. In 1998 its agency for vetting biotechnology approved GM soya. IDEC and others persuaded a court to block the decision. Earlier this year Lula said farmers could sell, just this once, the soya they had harvested. Mr Alencar's decree is another one-off exemption. It applies only to farmers who already have the seed (ie those in Rio Grande do Sul). It, too, is likely to be challenged in court. But the alternative, said the agriculture minister, Roberto Rodrigues, was “civil disobedience”. The decree requires farmers using GM seed to register with the government, but lax enforcement means few will.

A new law is supposed finally to settle the procedures for approving biotech products. The government has promised to send it to Congress this month, but has already missed deadlines. The pro-biotech Mr Rodrigues, himself a farmer, is tussling with his cautious colleague, Marina Silva, the environment minister, over how tough the procedure should be.

Foes of GM farming think they have an irresistible argument: the world does not want it. So say politicians in Paraná state, Brazil's second-largest soya producer, where the seeds are conventional. The state governor is pushing a local law that would ban GM soya from the state and close its port to GM crops.

Inconveniently for the antis, though, “many Paraná farmers want to produce biotech soya,” says Carlos Augusto Albuquerque of the local farmers' federation. The important thing is to segregate GM from non-GM varieties, which will be easier if Monsanto soya is legal. If the port is closed, biotech farmers will use others.

The reason for Mr Albuquerque's stance can be found in European kitchens. In Britain, where consumers are especially fussy, supermarkets sell pork and chicken raised on non-biotech soya for the same price they once charged for Monsanto-fed meat. They can do so in part because Brazilian farmers, the main source of non-GM soya, are paid little extra for it.

If Brazil shifts largely to biotech soya, non-GM farmers may at last gain the leverage to extract something more than the derisory premium they are accustomed to. For Europeans, that will come on top of the costs of complying with new regulations, which are about to mandate labeling of GM animal feed (though not of the meat itself) and an expensive paper trail to certify the purity of non-GM ingredients. If supermarkets pass such costs on, consumers' appetite for GM-free food could wane.

Thanks to Mr Alencar's one-year decree, the premium for non-GM soya in Brazil is rising already. The prospect of further gains will tempt Brazil to join the other soya superpowers in allowing the market to determine how much biotech seed to plant. If that happens, it will be Lula, not his vice-president, who takes the heat.

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Politics in Argentina

# The Mission

Oct 2nd 2003 | BUENOS AIRES
From The Economist print edition

## The president seeks allies, far and wide

Get article background

AP

Kirchner and his fair-weather friend

SINCE taking office in May as Argentina's president, having won just 22% of the vote, Néstor Kirchner has worked hard to strengthen his position. He engineered the removal of the head of the Supreme Court and faced down the army over prosecuting human-rights cases dating from the 1970s. Last month, he won a favourable deal from the International Monetary Fund, which he hopes will speed Argentina's recovery from its financial collapse of 2001. On September 28th, in the political backwater of Misiones province he won the first skirmish in what could be his most important battle of all.

Although Misiones, in Argentina's north-east, has only 1m people, the election of its governor gained national attention. For the first time, it pitted Mr Kirchner against his mentor and predecessor, Eduardo Duhalde. Mr Kirchner's candidate romped home against Mr Duhalde's man. The two played down the significance of this, joking that the only thing at stake was the barbecue they had wagered.

Really? Mr Kirchner has often said that his presidency will start in earnest on December 10th, when Mr Duhalde's term was originally due to end. By then, the current round of provincial elections for governors and the national Congress will be concluded—and Mr Duhalde will become the president's main challenger. That is partly because Peronism, to which both men belong, lacks serious opposition. The Peronists are heading for a majority in both houses of Congress, as well as 14 of the 24 provincial governments. But which Peronists? The best guess is that the likely total of 132 Peronist deputies in Congress's lower house will include 38 disciples of Mr Duhalde against 30 Kirchneristas.

That could be a problem if, as is widely assumed, Mr Duhalde's support will extend only as far as the president's popularity. Much divides the two men. Mr Duhalde no longer holds public office, but remains the unchallenged boss of the province of Buenos Aires, where he was twice governor. The province is home to two Argentines in five, and has long been notorious for its pork-barrel politics. Its top officials have no idea how many public employees the province has, since money is siphoned off to finance votes-for-jobs networks, according to Sergio Berensztein, a political scientist at Torcuato Di Tella University in Buenos Aires.

Mr Duhalde retains control over this political machine, which he deployed to help Mr Kirchner defeat his arch-enemy Carlos Menem, Argentina's president from 1989-99. As president, Mr Kirchner has largesse of his own, including discretionary spending which brings leverage over cash-strapped provincial governors and their representatives in the Senate. But Mr Kirchner derives most of his current authority from his sky-high poll ratings—earned by promising to be a crusading reformer. Sooner or later, that could bring him into collision with Mr Duhalde.

That may be why the president has begun looking for support beyond Peronism. In last month's election for mayor of Buenos Aires city, he backed the soft-left incumbent, who defeated a challenger supported by the Peronist party machine. The president has also flirted with independent candidates elsewhere, and courted left-wing trade unionists and parties. In Misiones he went further, backing an independent against a Peronist.

In a crafty attempt to limit these infidelities, Mr Duhalde is touting Mr Kirchner for the post of Peronist party president, to be chosen at a congress in November. Mr Kirchner shows no sign of accepting. But some Argentines wonder whether the president really has the stomach to tackle his party's corrupt old guard. Others reckon he has already begun too many battles. If he really intends to shake up his country's politics, he will have to strike before his aura fades.

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Latin American fisheries

# Tangled nets

Oct 2nd 2003 | LA JOLLA, CALIFORNIA
From The Economist print edition

**A conflict between animal rights and good ecology**

Get article background

TUNA, and how it should be fished in the eastern Pacific, has become the subject of a battle for the mind of lawmakers and consumers in the United States and Europe. On one side, fishermen, scientists and some greens support what they see as environmentally sound fishing. On the other, animal-rights activists accuse the first group of promoting the death of dolphins. But just what constitutes “dolphin-safe” tuna? The answer is important for the future of the fishing industry in half-a-dozen Latin American countries.

In the eastern Pacific—the fishing ground for tuna boats from Mexico, Central America, Colombia, Ecuador and Venezuela—yellowfin tuna, more valuable than their skipjack cousins, are often found swimming with schools of dolphins. Some fishermen therefore chase the dolphins, which swim on the surface, and cast their nets round them in order to catch the deeper-swimming tuna.

In the past, the dolphins died in droves. In the 1980s, Earth Island Institute (EII), an animal-rights group based in San Francisco, launched a campaign to stop the slaughter. Facing consumer boycotts, the three main tuna companies in the United States decided to stop buying from boats which targeted dolphins. The “dolphin-safe” rule became federal law. The campaign then spread to Europe.

Earth Island Institute now has the industry in its grip. It has a list of producers and processors that meet its own definition of what is safe for dolphins. It also promotes alternative ways of fishing tuna, such as luring them with floating objects.

Over the past decade, however, fishermen have become much better at catching yellowfin without harming dolphins. Techniques and nets have been changed to allow the mammals to escape. In 1998, an international agreement—now endorsed by the United States, the European Union, Vanuatu and 13 Latin American countries—set rules to limit dolphin deaths to fewer than 5,000 a year, a number thought sustainable. Last year, out of an estimated population of more than 9m dolphins in the eastern Pacific, fewer than 1,600 died, compared with 133,000 in 1986.

In Earth Island's view, however, no dolphin should die. It claims that some dolphin species are not recovering as fast as they should, and that the chase for tuna provokes indirect, uncounted deaths. The Inter-American Tropical Tuna Commission (IATTC), an intergovernmental body based in California which monitors the 1998 “dolphin-safe” agreement, retorts that scientists do not agree on how fast dolphins would reproduce if left undisturbed. It also points out that techniques used to catch skipjack, classified as “dolphin safe” by Earth Island, involve a much higher unwanted by-catch of young tuna, sharks and turtles. Mario Aguilar, of Mexico's National Commission of Fisheries, stresses that chasing dolphins is the greenest way to fish tuna. Greenpeace agrees, as does the World Wildlife Fund.

**Not a dead dolphin in sight**

So pressure is building to review the dolphin-safe definition in the United States. But in 1999, a first attempt to ease the law was in turn challenged in court by the EII. Last December, the United States' National Marine Fisheries Service concluded that fishing tuna by targeting dolphins had little impact on dolphins. But the courts have yet to accept a change in the legal definition of “dolphin safe”.

The dispute does much harm to fishermen. The American embargo on Mexican tuna was lifted a few years ago in 1999. But since American law prevents Mexican tuna from being labelled as “dolphin safe”, almost nobody in the United States will stock it. In the 1970s, Mexico sold most of its tuna catch to the United States. Today, about 80% of it is consumed at home. But other Latin American fishing countries have smaller domestic markets.

Demand for yellowfin tuna is rising in Europe. But selling there is difficult, says José Rodriguez Cruz of Grupo Mar, a Mexican fishing company, because of tariffs and quotas, and pressure on processors from Earth Island. Some European buyers, while ostensibly adhering to Earth Island rules, become less picky when tuna is scarce; the institute cannot check thoroughly. In a rare protest at this hypocrisy, Calvo, a big Spanish processer, decided last year to withdraw from Earth Island's list and to follow the IATTC's standards.

Even if the rules change, the three main American processors, who supply 90% of canned tuna in the United States, say they will not buy fish whose capture had anything to do with dolphins. The image of Flipper suffocating in a net is still too hard for some to stomach—even if “dolphin-safe” tuna may be ecologically incorrect.

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Mexico and the United States

# Storm in a tequila bottle

Oct 2nd 2003 | MEXICO CITY
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**Protectionism, or quality control?**

TEQUILA is as Mexican as big hats. To deserve the name, it must be distilled only from the sap of the Mexican blue agave plant. Happily, however, it has become a favourite spirit in the United States, which accounts for over half the world's tequila consumption. A shared taste for *margaritas* can often soothe the frequently niggling relations between the two countries. But now tequila itself has become the subject of a tetchy trade dispute—one that looks as if it will not be settled over a couple of shorts.

At the moment, 83% of the tequila sold in America is imported in bulk and then bottled locally. Now, Mexico's government wants to ban bulk shipments, and require tequila to be bottled in Mexico. It argues that this is vital to protect quality. The Tequila Regulatory Council, a quasi-governmental body, claims to have evidence that bulk handlers on both sides of the border have tampered with the product or, worse, blended different varieties of tequila.

Many Americans suspect that the Mexican move has less to do with quality-control than with moving all those bottling jobs south of the border. Since George Bush faces criticism over an economy enjoying a “jobless recovery”, his administration is taking these complaints seriously.

In addition, says Peter Cressy of the American Distilled Spirits Council, an industry group, upsetting his members risks undermining the hugely successful effort they have made to promote tequila. Its consumption in the United States rose last year to 7.2m nine-litre cases (worth $2.8 billion in retail sales) from just 4.4m cases in 1991. Ending local bottling could lead to higher prices, eroding tequila's market share, says Mr Cressy. He argues that there is “no systemic evidence” of a quality problem.

Both sides claim to have the rules of the North American Free-Trade Agreement and the World Trade Organisation on their side. It would seem that much litigation lies ahead. Alternatively, Mexico might copy the French wine trade and persuade consumers of the superiority of tequila *embotellado en la propiedad* in Jalisco, rather than in a Los Angeles factory.

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Pakistan and America

# My enemy's enemy

Oct 2nd 2003 | LAHORE
From The Economist print edition

PA

**Al-Qaeda has called for General Pervez Musharraf's overthrow, as Pakistan's alliance with America starts to look a little less solid**

Get article background

GET Musharraf. That was the blunt message conveyed on September 28th on al-Jazeera television by a taped message, purportedly emanating from Ayman al-Zawahiri, the right hand of Osama bin Laden. Muslims in Pakistan must unite to oust this traitor, said the voice. They have tried already. In the last two years, there have been at least two serious attempts on General Pervez Musharraf's life.

Since September 11th 2001, Pakistan's president has been an invaluable ally of the United States. He was quick to grant bases to the American air force in October 2001, aiding its onslaught on the Taliban regime in Afghanistan. Then he allowed the FBI to set up shop in Pakistan, helping to nab more than 500 suspected al-Qaeda activists, including senior ones such as Khalid Sheikh Mohammad, Abu Zubaydah and Ramzi bin al-Shibh, who have been swiftly extradited to America's base at Guantanamo Bay in Cuba.

More recently, General Musharraf has further angered Muslims in general and Pakistanis in particular by suggesting that Muslim states should consider granting diplomatic recognition to Israel and sending troops to Iraq for peacekeeping. While he was speaking to the UN General Assembly on September 24th, he exhorted Muslim nations to eschew extremism and confrontation. In interviews, he has given warning that Islamic extremists are perverting their faith by waging reckless holy wars across the globe.

Words abroad are matched by action at home. In the past fortnight, Pakistan's intelligence agencies have swooped upon a couple of *madrassas* (religious schools) in Karachi and arrested 19 foreign students, mostly from Indonesia and Malaysia. Among them is Gun Rustam Gunawan, the younger brother of Riduan Isamuddin, also known as Hambali, a leading activist of the Indonesian terrorist organisation Jemaah Islamiah. Hambali, who was arrested last month in Thailand, is accused of masterminding a string of bombings across South-East Asia, including the car bomb in October 2002 that killed 202 people, mostly western tourists, in Bali.

On best estimates, Pakistan contains more than 586,000 students in nearly 4,000 *madrassas*. Some 16,600 of these students are foreigners, mostly from Arab and African countries. Since the general's crackdown on extremists last year, scores of such foreign students have fled Pakistan for unknown

destinations. Indeed, Mufti Jamil, a spokesman of the Federation of Madrassas in Karachi, complains that Pakistan is no longer a safe place for foreign students from the Muslim world. The federation is planning a legal challenge against the detention of the latest batch of religious students.

All of this has earned General Musharraf political credit in Washington. He has drawn heavily on it. In the last two years, the IMF and World Bank have helped Pakistan to reschedule $12.5 billion in outstanding debt to western countries, and provided more than $1 billion in soft loans. The Americans have helped by suspending all the military and economic sanctions they clamped on Pakistan in 1990 and 1998 for acquiring nuclear weapons. Last year the United States wrote off $1 billion in bilateral debt, and this year George Bush promised Pakistan another $3 billion in grants over the next five years. In Washington this week, General Musharraf's prime minister, Zafarullah Jamali, tried to persuade Mr Bush to sell new weapon systems to Pakistan to counter the billions of dollars of advanced weapons India has bought from Israel in recent years.

After all these withdrawals, could the general's credit balance in Washington now be heading towards the red? Many in the West continue to have mixed views about his stewardship of the country. Last week, the (formerly British) Commonwealth voted to extend Pakistan's four-year suspension from the club for not being sufficiently democratic. Many western governments are unhappy that General Musharraf's divisive policies at home have sidelined the moderate mainstream parties, enabling Islamist parties to make unprecedented gains in two of Pakistan's four provinces.

It is, however, in America where Pakistan's sharpest critics are to be found. They accuse Pakistan's national-security establishment, run exclusively by army generals, of having sold nuclear know-how to North Korea in exchange for Korean missile technology so that Pakistan can deliver its nuclear warheads. Pakistan has also been implicated in the transfer of nuclear technology to Iran. All these are vigorously denied.

Still, it is General Musharraf's lack of appetite for battling the remnants of the Taliban in Afghanistan that causes most muttering and hand-wringing in Washington. These men conduct hit-and-run missions against Kabul's security forces from hideouts in Pakistan's tribal borderlands. Despite an announced offensive this week, the general's critics say his army intelligence service has been supporting and protecting them. The recent arrest of three Pakistani officers alongside Taliban fighters in Afghanistan highlighted such worries. Afghanistan's president, Hamid Karzai, has openly criticised Pakistan for sheltering and arming the Taliban.

The West also worries about General Musharraf's continued support of insurgents in Kashmir. The fear is that this might provoke India to retaliate, raising the spectre of a nuclear conflict. Behind the scenes, senior American officials continue to urge General Musharraf to stop infiltration across the disputed border with India in Kashmir. Richard Armitage, the deputy secretary of state, and Christina Rocca, the assistant secretary of state for South Asia, arrived in Islamabad on October 2nd. They have much to discuss.

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India

# A too-helpful act

Oct 2nd 2003 | DELHI
From The Economist print edition

**Some politicians are locking up their opponents as terrorists**

A LANDMINE attack on October 1st, on the convoy of Chandrababu Naidu, chief minister of the state of Andhra Pradesh, was a reminder of the variety of terrorist threats facing India. Mr Naidu was lucky to survive the assassination attempt, presumed to be by the People's War Group, a Maoist faction that has issued his “death warrant”. Such groups, combined with long-running insurgencies in Kashmir and the north-east and newer extremist Islamist outfits, are used to justify the draconian provisions of India's Prevention of Terrorism Act (POTA), passed into law last year. But critics say the law has been much abused—by both police and politicians.

In the latter category, Jayaram Jayalalitha, chief minister of Tamil Nadu, is in the spotlight. She has demanded the sacking of M. Kannappan, India's minister for non-conventional energy sources. She accuses him of making a speech in support of the Liberation Tigers of Tamil Eelam, a Sri Lankan insurgent group that has committed atrocities on Indian as well as Sri Lankan soil, including the assassination of Rajiv Gandhi, a former Indian prime minister. She has threatened to use POTA to arrest Mr Kannappan, who is a member of a party in opposition in Tamil Nadu, but part of the ruling national coalition.

Some lawyers claim POTA is unconstitutional because it infringes the rights of free speech and association and permits arbitrary detention. Particularly dangerous is the low standard of evidence permitted: confessions given in police custody are admissible against both the confessor and his co-accused, an open invitation for police beatings. The law is available to both central and state governments. In Uttar Pradesh, India's most populous state, the former government led by Miss Mayawati used it to detain a number of its opponents, including Raja Bhaiya, a well-known local warlord. Miss Mayawati's government fell in August. Its successor quickly ordered his release.

Suspicions of inconsistency abound. In Gujarat, 123 Muslims were charged under POTA for a murderous arson attack in 2002 on a train carrying Hindu activists, but the act has not been invoked in investigating the anti-Muslim pogrom that followed. The small eastern state of Jharkhand, not known as a hotbed of terrorism, has 745 POTA accused, including a number of children.

Civil-rights lawyers recall the abuses of the Terrorist and Disruptive Activities (Prevention) Act, which lapsed in 1995 after nearly 80,000 people had been detained nationwide, but only 1% of them convicted. POTA expires next October, but is likely to be extended. The opposition says it will repeal it. But Sushil Kumar, a defence lawyer, is doubtful: “It becomes very handy for any government when it comes back to power,” he says.

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Bangladesh and India

# The straight path

Oct 2nd 2003 | DHAKA
From The Economist print edition

### The taxing new route to Kolkata

Get article background

A NEW bus route from India to Bangladesh may not seem like everyone's idea of a successful business venture. Since its formal launch last week, it has failed to attract more than ten passengers per journey. Yet both Delhi and Dhaka say that their recent agreement to open the first direct overland link between the far-eastern states of India and Bangladesh is hugely significant.

The twice-daily service from Dhaka to Agartala, the capital of the Indian state of Tripura, enables Indians living in the inaccessible far east of the country to go overland to Kolkata (formerly Calcutta) or Delhi via Bangladesh. It also raises the prospect of boosting trade on the Tripura border—surrounded on three sides by Bangladesh—which until now has been effectively at a stand-still.

In the past, Indians wanting to go from Tripura to Kolkata had either to travel by air or make a convoluted 1,750-km (1,100 mile) overland journey via Guwahati, capital of Assam. Besides its dangerous mountain passes, the “chicken neck”, which connects the country to its seven north-eastern states, has often been targeted by Assamese insurgents, leaving the Seven Sisters—as the states are affectionately known—sometimes cut off from the rest of India. Thanks to the new bus route, the journey is now half as long for those passengers who don't mind the hassle of changing buses in Dhaka and the inconvenience of Bangladesh's notoriously overcrowded and pot-holed roads.

So far, however, only a handful of people have made the journey. The $10 travel tax imposed by the Bangladeshi authorities, and what India claims is their refusal to issue transit visas to thousands of Indians in Tripura wanting to go to Kolkata, are deterrents. Bangladesh says that the tax is needed to cover the cost of administering the new service and points out that it is fair, since all travellers have to pay. It also says Indian passengers can always apply for a double entry visa, ignoring the fact that this is expensive and time consuming.

Meanwhile, it's business as usual for the thousands of day labourers from both countries who cross the porous border on a daily basis. Not for them the worries of getting visas or filling forms in triplicate. Sometimes, it's a lot less complicated to travel on foot.

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Kazakhstan

# In the name of the father

Oct 2nd 2003 | ALMATY
From The Economist print edition

**Dariga Nazarbaeva's political ascension**

Get article background

IN THE male-dominated world of politics in Kazakhstan, where few things are stronger than blood ties, the fact that President Nursultan Nazarbaev has three daughters and no son may be a good thing. Even so, two of his sons-in-law have already been meddling in state affairs and the oil business. But now there are signs that the authoritarian Mr Nazarbaev, a nimble 63-year-old who has been at the helm for the past 13 years, may be planning ahead for the day he leaves the political scene.

Short of a convenient Putin—the successor handpicked by former Russian President Boris Yeltsin—Mr Nazarbaev has to make do with what he has. So it did not come as a total surprise last month when his eldest daughter, the 40-year-old Dariga Nazarbaeva, announced the creation of a new political party.

The president's immediate concerns are the parliamentary elections scheduled for 2004, followed by a presidential vote in 2006. Although last year's strict law on political parties drastically reduced their number from 19 to seven—and effectively undermined the country's opposition—the president's support base has not noticeably increased. Three of the surviving parties, Otan, the Civil Party and the Agrarian Party, are pro-presidential but they are poorly organised and rather ineffective.

Ms Nazarbaeva's new political party, Asar (which means “all together”), may therefore come in handy. Asar started life a few months ago as a social movement set up by the president's daughter to help the poor and needy. As of yet, it does not have a political platform. But given its lineage, the new baby can safely be expected to receive a lot of tender loving care.

Over the past few years, Ms Nazarbaeva's public profile and responsibilities have gradually increased. Once overshadowed by her powerful and ambitious husband—who has now been shipped off as an ambassador to Vienna—she has grown from a shy woman barely audible when speaking in public to the self-confident chairman of the Khabar media group, the head of Kazakhstan's journalism association and a publicly acclaimed singer, who recently performed at the Bolshoi Theatre in Moscow. She now stands at the side of the president when he receives heads of state and their wives.

Yet having a woman lead a big national party could be something of a stretch for many Kazakhs. Murat Auezov, formerly an opposition figure and now a co-founder of Asar, has hastened to explain on Khabar's news channel—which is owned by Ms Nazarbaeva—that this is in fact in full accordance with Kazakh traditions. The president's daughter and her newly-found voice will be, as an old saying has it, the guardian of the nation's hearth.

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Afghanistan

# Biting the hand that feeds

Oct 2nd 2003 | MAYDAN SHAHR
From The Economist print edition

**Aid workers have become targets of choice**

THE tinsel-clad petrol station at the edge of Maydan Shahr, a desert town west of Kabul, feels like a portal to another and more dangerous country. Aid workers stop here to check tyres and oil on their jeeps. They do not want to break down. Ahead is southern Afghanistan—a bloody mess that is getting bloodier. Armed attacks on aid agencies in the south, once sporadic, are now daily. Such attacks used to extend only to a pistol whipping. The new rules for those stopped by insurgents are more brutal. If you are a foreigner you will be executed. If you are an Afghan working for a foreigner you will be hectored, perhaps mutilated, and then executed. Afghan aid workers are the prime targets. Seven were killed last month.

The aim of the insurgent “neo-Taliban”—a bunch that also includes tribal malcontents, drug traffickers, and other ill-educated chancers—is to drive aid workers out of the Pushtun south. By scaring off donors and then blaming the resultant penury on Hamid Karzai's government, they hope to strengthen their hand before next year's elections or, better still, sink the election process altogether. But scaring foreigners away is an end in itself for conservative Pushtuns who see foreigners as a contaminant, and likewise for those whose tribal enemies currently benefit from CIA largesse, or those who would prefer a security vacuum that makes it easier for them to process and shift heroin.

The strategy may be too cruel to be sustainable, but so far it is succeeding. Afghanistan is on the verge of a bifurcation between a safe and politically engaged north and a dodgy and alienated south. The United Nations thinks 16 of Afghanistan's 32 provinces—almost all in the south—too dangerous for its international staff to venture through. Red Cross officials privately say their marked vehicles are proving a liability. Red Crescent workers are no better off: several were recently murdered.

The failure of the American-led coalition to foresee or contain this southern insurgency has left less-equipped aid agencies in an even worse position. Care International, for instance, has been working in Afghanistan for 30 years without interruption. All of its 700 or so field staff are Afghans. But a threatening letter pinned to the door of one of its offices in Ghazni province was followed up by a rocket attack on September 28th. The choice now facing Care and many other donors in the south is grim: stay and risk the lives of its staff or leave and see its programmes collapse.

It could get worse. If neo-Taliban are happy to murder those bringing food and water, what might they do to those bringing democracy and rights for women? Officials charged with going out and registering Pushtun voters for the elections will be sitting ducks. And if the neo-Taliban cannot get at them, they may turn on those registering to vote, just as they have stepped up their campaign to burn down girls' schools.

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China

# Let a thousand papers wither

Oct 2nd 2003 | BEIJING
From The Economist print edition

**China's stuffy press gets a shake-out**

BY THIS week, hundreds of unprofitable government-run newspapers in China were likely to be closed down for good. In the coming months, thousands more state-owned newspapers and magazines will be forced to turn a profit through fair competition or face a similar fate. The Chinese media are calling it the biggest ever shake-up of the country's mostly tedious and unmarketable newspapers and periodicals. Some experts predict that as many as half of them will not survive. Few will mourn their loss.

The first stirrings of the campaign were felt in June, when the authorities ordered news publications to postpone taking subscriptions for 2004 until the end of September. The reason became clear the following month with the issuing of regulations auguring the closure of large numbers of state-controlled publications. At the end of last year, China had 2,137 newspapers and 9,029 magazines. The new rules aimed to trim these numbers drastically and turn the rest into commercially viable operations—with exceptions made for a handful of the Communist Party's most cherished mouthpieces.

The regulations said that by the end of September, newspapers run by county level governments and Communist Party committees would be axed entirely, except for those with an advertising revenue of more than 4m yuan ($480,000) annually. The Chinese press said this would mean the closure of nearly all of the 309 officially registered county newspapers

But the big changes are yet to come. The regulations say that newspapers must be made financially independent from the government. The only exceptions are to be the *People's Daily* (the party's mouthpiece) and the magazine *Seeking Truth* (its top periodical). In addition, each province can fund two publications and each city one. Even more critically, mandatory subscriptions (usually imposed on government departments) are to be abolished.

Some may survive by forcing the public to pay. The official media reported in September that a tax bureau in the northern province of Shaanxi funded a tax publication by telling businesses that unless they subscribed, the bureau would not handle their tax submissions, while any business failing to hand over tax would be heavily penalised. But the new rule says that any publication that currently earns less than 50% of its revenues through voluntary subscriptions will close.

How tough the government will be in implementing the regulations is yet to be seen. But the impact could be huge. In recent years, some papers have already had to rely increasingly on advertising for their survival, resulting in fiercer competition and therefore livelier content—sometimes including issues the party would prefer to keep quiet about. The party could save a fortune by cutting off all subsidies, but its grip on the press would then be weaker.

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South Korea

# Roh goes it alone

Oct 2nd 2003
From The Economist print edition

**The president quits his party, just six months before elections**

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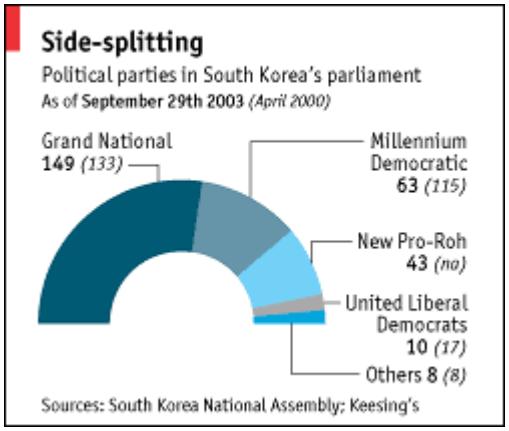


SINCE taking office in February, Roh Moo-hyun has often seemed indecisive in the face of events, be they strikes or North Korea's nuclear posturing. Now Mr Roh faces yet another tough choice. Thirty-eight pro-Roh members of the National Assembly have bolted from the Millennium Democratic Party (MDP), which Mr Roh used to call his own. The president responded on September 29th by leaving the MDP as well, but without—at least, he says, for now—joining the new group. He must now decide whether to use the split as a chance to start afresh, or merely as another reason to prevaricate.

As with other hard choices he has faced, Mr Roh could hardly have been surprised by the MDP's break-up. The fissure has been apparent since last year, when he came from obscurity to win the party's primary contest and secure its presidential nomination. Much of the MDP's establishment, including members who were loyal to the outgoing president, Kim Dae-jung, refused to back Mr Roh, and tried to undermine the party's support for him before the presidential election in December. Mr Roh's supporters never got over this. Members of the new pro-Roh party also back many of the political reforms that Mr Roh has tried to champion.

One of these is a bid to weaken South Korea's fierce regional loyalties. The MDP has derived most of its support from the south-western Cholla region, whereas the rival Grand National Party (GNP) is especially strong in the south-eastern provinces surrounding Busan. Mr Roh has long said that this needs to change. His supporters in the new party agree, and form a more geographically diverse bunch than the rump MDP. In next April's National Assembly elections, they can hope to do well in Seoul's sprawling conurbation, as well as in the GNP heartland.

Although both MDP groups are left-of-centre, the splinter group is critical of the way both the GNP and the MDP operate. Both parties, it says, are too beholden to moneyed interests, and contribute to a corrupt and inflexible system. The only difference between them, the splinterers reckon, is that while the GNP is outwardly conservative, the MDP talks progressively and then betrays its values. The 38 MDP defectors have been joined by five left-of-centre members of the GNP.

The new party would thus seem to offer Mr Roh a clear, albeit small, base in the assembly from which to begin pressing an agenda. He will be hampered by his lack of wider support—though this was a problem even before, since the MDP did not command a majority. He has often said that his goal is to make Korean democracy more transparent and less hierarchical. In his first half-year, however, he has failed to show the public what he means. To his credit, he has shaken up the prosecutor's office, and has tried to sever the cosy ties between bureaucrats and the media. But he seems only to have emboldened militant labour-unionists, who have launched several crippling strikes on his watch. And with the economy weak, he has only half-heartedly pursued his pledge to make family business conglomerates more transparent. Will he seize this chance to show South Korea his plan?

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# Correction: China's Muslim population

Oct 2nd 2003
From The Economist print edition

In our survey of Islam and the West, published on September 13th, a map gave the Muslim population of China as 133.1m. China's own estimate of 18m may be too low, but our number was wildly inflated. Sorry.

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Iraq's reconstruction

# Cleaner, but still bare

Oct 2nd 2003 | BAGHDAD
From The Economist print edition

Getty News

**The Iraqis have yet to see much of the talked-about reconstruction**

“LONG Live Saddam” read the scrawls on the bombed bridge over the Diyala river, one of the two arteries leading out of Baghdad to Basra. Queues of hooting vehicles snake north and south over a makeshift crossing the American army has left in its place. The bridges were quickly rebuilt after the 1991 war, says an angry driver. “Saddam would have done better.”

Six months after the war, Iraqis do not understand why so little of America's promised reconstruction has materialised. According to USAID, road reconstruction by September amounted to a 1.5km (one-mile) bypass. Of the 49 damaged bridges surveyed by Bechtel, the San Francisco construction company that is being paid by USAID to supervise Iraq's reconstruction, work has begun on only three. “It's peanuts,” says Mahmoud Bunnia, director of the Iraqi company that secured a Bechtel contract to repair the bridges.

In many ways, life for Iraqis is better than it was under Saddam. All but Baathists enjoy freedom of speech and the right to complain. State employees have seen their salaries rise up to 40-fold. Import duties have collapsed from 400% to zero. The detritus of war has been removed, and the streets have sweepers getting $3 a day. But on October 1st Iraqi troops fired over the heads of protesters demanding jobs, and the continuing violence meant that parents feared sending their children to the schools that reopened this week.

And reconstruction has hardly begun. Half of Baghdad's 500,000 phone lines are still out of action. Without electricity for irrigation, many fields are parched to dust. Iraqis have to struggle to find evidence of where their oil wealth, and American tax-payers' money, have gone.

American officials in the Coalition Provisional Authority (CPA) that runs Iraq say it is simply a matter of time. Before Bechtel could start work it had to assess the needs, and get approval from USAID, a process that took till July. In the two months since it began sub-contracting, Bechtel says it has been concentrating on the poorer provinces, out of sight of Baghdad. It has renovated 1,100 looted schools, about 10% of the total, and hundreds of thousands of schoolchildren have new satchels emblazoned with the USAID logo. Over the course of its 18-month programme, it will, it says, tender $300m in sub-contracts, of which 70% will go to Iraqis.

Much more money will be on its way when, or if, Congress approves George Bush's multi-billion package ($20.3 billion for Iraq's capital budget, and $51 billion in military logistics). Donor countries will meet in

Spain in a month for pledge-making, where they will be presented with a study by the World Bank and others, which is said to estimate Iraq's reconstruction needs at $55 billion over four years.

Iraq's oil production is picking up, rising to 1.9m barrels per day, though still down on pre-war levels of 2.5m bpd. Oil revenues have so far earned some $1.6 billion since exports began again in June. Even if output stays flat, says the CPA, oil revenues by the end of the year will be $4.9 billion, exceeding budget targets. And the authority plans to reopen Iraq's sabotaged pipeline to Turkey in mid-October.

Compared with the 11-figure sums bandied about by the CPA, actual investment is paltry. Bechtel says that the $680m it is receiving from USAID amounts to less than 5% of its $16 billion assessment of Iraq's civilian reconstruction needs, and is enough for “critical” projects only. And these figures are disappearing behind rising insurance premiums, and the cost of private protection.

Despite the lifting of sanctions and the proliferation of satellite channels, many Iraqis feel as cut off from the outside world as ever. Faced with the threat of ground-to-air missiles, the country's airports remain closed to commercial traffic. Iraq's link eastward to Jordan is plagued with bandits. The CPA is barricaded behind concrete walls. The United Nations and many aid agencies have left. The hotels that buzzed immediately after the war are empty. Only journalists, who feed on misery, are heaving up property prices.

Security woes have slowed reconstruction, but Iraqis are asking whether something more structural is to blame. The CPA, the nucleus of Iraq's civil service, has a staff of just 1,200 (called “advisers” in CPA-speak). Crammed into a palace with Saddam's aphorisms inlaid on the walls, these workers are overloaded and dog-tired. They are cut off from the Iraqis, and unfamiliar with the country they are supposed to serve. A mortar attack last week on the Rashid hotel, the CPA's residential compound, dented the belief that the safe-zone was safe. Flyers for courses in terrorist awareness are pinned to the palace walls.

There is a worrying suspicion that the CPA is working to meet Washington's needs more than Iraq's. Haunted by the prospect that Iraq might not be the promised beacon of democracy come America's election next year, Mr Bush's campaign team is setting targets that the CPA cannot deliver. Officials say that Washington is pushing for Iraq's elections to be held ahead of America's. But this could puncture efforts to draft a constitution that balances Iraq's competing factions, a process Iraqis say will take more than a year.

CPA officials also fear that Congress may wrap Iraq's 2004 finance package in ties that benefit America's economy more than Iraq's. In an effort to speed up reconstruction, say these officials, big contracts were awarded in Washington without a competitive bidding process. Civilian reconstruction went to Bechtel. Kellogg Brown and Root, a subsidiary of Halliburton, the oil-services company that America's vice-president used to run, boosted its small initial contract to many hundreds of millions of dollars by securing oil-sector reconstruction, plus military provisions that run from lavatories to laundry.

## Leave it to us

Should Congress approve Mr Bush's package, the benefits will trickle down to Iraq. But Iraqis believe they could do the reconstruction job better, and at a fraction of the cost, if they were given the money and the go-ahead. For example, in the budget he presented to Congress, Paul Bremer, the American administrator, set a price-tag of $50,000 for each of his 8,000 new prison beds. The Iraqis, who know a lot about prisons, believe they could do it for less.

Empowering Iraqis would also reassure those who have begun to fear that the country's economy is no longer theirs. The new finance laws, announced recently, were hailed by the CPA as “setting the most far-sighted investment climate in the Middle East”. But they have alienated the country's initially enthusiastic bourgeoisie. “The lessons from eastern Europe are that where people didn't act quickly they paid for it dearly,” says a CPA economist. But eastern Europe was not a war-zone.

Iraqis feel that they are struggling enough already without investment laws that allow foreigners to buy up Iraqi firms, and repatriate the profits. “Before, Saddam Hussein took our money out of the country, and now the big corporations do,” said Mr Bunnia, who after garnering the fattest contracts should be one of Iraq's happiest merchants. “What's the difference?”

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Iraq and Jordan

# A delicate state of affairs

Oct 2nd 2003 | AMMAN AND BAGHDAD
From The Economist print edition

**Iraqi royalists look to Jordan for a king. But then, there's Ahmed Chalabi**

BENEATH a Hashemite coat of arms in the ex-headquarters of Iraq's intelligence agency, the chairman of the Royal Democratic Alliance, one of Iraq's new parties, calls for the restoration of the country's former Hashemite monarchy, and for federation with Jordan. King Abdullah of Jordan, he decrees, should be the federation's king. This week, he is leading a mission to Amman to appeal to the king.

Awkwardly, Ahmed Chalabi, who is one of Jordan's least favourite people, is the Iraq Governing Council's current president (though the monthly changeover is due). In 1989, a Jordanian military court indicted Mr Chalabi for embezzling something like $300m of state funds.

The battle for Iraq's leadership has intensified the feud. In August, Jordan's parliament called on Interpol to extradite Mr Chalabi to stand trial. And royalist corridors are thick with improbable whispers: Mr Chalabi's house borders their party's building, and he sends, they claim, Ali Babas over the wall on looting sprees.

Yet there was a time when the Chalabis and the Hashemites were the best of friends. Mr Chalabi's father was president of Iraq's Senate before the 1958 regicide, and his family were royal bankers. The relationship flourished into the 1980s when Mr Chalabi, aged 32, founded Petra Bank. With the patronage of Prince Hassan, at the time heir apparent, he nurtured it into becoming Jordan's second bank.

In 1989 the relationship, and the bank, collapsed. Mr Chalabi fled the kingdom in the boot of a car, after the late King Hussein, Abdullah's father and Hassan's brother, ordered an investigation into the biggest bank scandal in Jordan's history. Of the 48 names indicted, 13 were convicted, including nine Chalabis. Mr Chalabi himself, sentenced in absentia, received 22 years' hard labour.

So is the president of Iraq's Governing Council a bank robber? Mr Chalabi says the charges were politically motivated. Hussein was merely bowing to the wishes of his oil-supplier and neighbour, Saddam Hussein. Mr Chalabi has, he says, 25 tonnes of documents to prove this. And he may have a point when he claims that the Jordanians had a motive: Jordan's Palestinian financiers, who control banking, were mightily jealous of the Iraqi upstart.

Can calmer heads prevail? At stake is the rather cosy Jordanian-Iraqi relationship that flowered under Saddam Hussein. Saddam's regime provided Jordan with near-free oil, and contracts under the oil-for-food programme which ran into billions. In turn, Jordan's banks gave Iraq, besieged by sanctions, an account in exile. And its police handed wanted migrants back to the Baathist regime.

Jordan had expected to do rather well out of the war. It has garnered some American military contracts, the bounty of a $1.5 billion dollop of American aid, and it has been reluctant to return hundreds of millions of dollars in frozen Iraqi reserves. But with Mr Chalabi stalking the corridors of power, the benefits could begin to diminish. “He's not innocent. He's been condemned by our courts,” says Mahmoud Obeidat, Jordan's state prosecutor. “But how can he serve 22 years if he's a head of state? It won't be us imprisoning him, it's he who will imprison us.”

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Egyptian politics

# Surgery on hardened arteries

Oct 2nd 2003 | CAIRO
From The Economist print edition

**Could Egypt's unchanging politics be changing?**

A PARTY that has governed for a quarter of a century would seem an unlikely instrument for change. But the National Democratic Party (NDP), the lumbering patronage machine that holds all but a few seats in Egypt's rubber-stamp parliament, has just embraced a platform of sweeping economic, political and social reform.

Are Egyptians impressed? By and large, no. They have heard such promises before. Their reflexive cynicism is further soured by a deepening economic slump, which has spawned a contempt for the state that cuts clear across classes. In recent months inflation has surged and investment stalled. Queues for subsidised bread have returned for the first time in a generation. A sharp plunge in the value of Egypt's currency since the beginning of the year has collapsed purchasing power for everyone.

AFP

**Elegantly presented heir**

Many see the new pledges as either a sop to America, a key aid donor that is impatient to see its Arab clients liberalise, or as a cheap palliative to rising public anger. Or, some say, the changes are a vehicle to promote the prospects of Gamal Mubarak, the son and, perhaps, heir to Egypt's long-serving president.

Yet under the congealed surface of politics, real change may be brewing. At the NDP's just-concluded yearly congress, the usual owlish cast of regime stalwarts filled the front rows, among them the powerful ministers who have held their posts since Hosni Mubarak, the party's nominal head, came to power two decades ago. But it was the fresher faces, seated farther back, who actually set the agenda.

## The pupils at the back

Since being named head of a specially created NDP policy bureau last year, the younger Mubarak has packed the party's upper ranks with like-minded liberals. Dominated by western-educated academics and entrepreneurs, this emerging team had until recently made slow headway against the entrenched interests that clog the arteries of both party and government.

For instance, its influence was seen in moves earlier this year to abolish Egypt's harsh State Security courts, and to create a board to promote human rights. In practice, neither change had much impact. Torture continued, and other courts that bypass normal legal channels still confront dissidents with unappealable sentences. In March, Egypt's parliament blithely renewed emergency laws, restricting political freedom, that have been in force, in some form, for all but eight years since the second world war. The party's ageing bosses seemed to see their upstart rivals as harmless wannabes, rather like Britain's Prince Charles with his model villages.

Lately, however, they have shown more receptiveness to the need for change. Gamal Mubarak's policy bureau has initiated punchier legislation, such as a long-delayed bill that will allow women to pass Egyptian nationality to their children, so rescuing an estimated 25,000 citizens from statelessness. And this week, the NDP congress adopted wholesale the recommendations of seven policy papers presented by Gamal's team.

If applied, the changes could sweep aside restrictions that have crippled competitive politics, such as the arcane electoral rules that allow for blatant vote-rigging, and the curbs on political parties that have turned Egypt's opposition into what one Cairo columnist dismisses as “toothless, clawless kittens”. Other mooted reforms include an overhaul of the notoriously arbitrary tax system, and of the mind-numbing curriculum in Egypt's state schools. What Gamal's team wants, say loyalists, is to transform the NDP from a party of the government, mobilised only at election time, into a proper governing party that stands for principles.

As if to herald Egypt's entry into a more liberal age, the end of the party conference coincided with the release of 900 Islamists out of the estimated 10,000 political prisoners in Egypt's jails. Among those reprieved were several top leaders of the Gamaa Islamiya, a group responsible for dozens of terror attacks in the early 1990s.

At the same time, President Mubarak himself announced the abrogation, at one go, of 2,000 military decrees. Among these restrictions was one that banned Egyptian charities from receiving foreign funds without government sanction, a rule used to prosecute human-rights activists.

All of which sounds nice, except that few Egyptians are convinced that the ruling elite is capable of real reform. The dominant suspicion is that the game is not change, but a bid to smooth the transfer of power to another generation within the same entrenched establishment. The process will be completed, perhaps, when Mr Mubarak's term expires in 2005.

It is not that his 40-year-old son lacks supporters. Gamal impresses even critics as serious and pragmatic. The fact that he is cutting his teeth in civilian politics, not in the army as did his father, and Egypt's previous presidents, is appreciated. But people still bridle at the notion of a hereditary presidency, however subtly cooked, daintily garnished and elegantly presented.

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Terrorist finance

# Al-Qaeda operations are rather cheap

Oct 2nd 2003 | STOCKHOLM
From The Economist print edition

**Small sums, slipped quietly across borders, are very hard to block**

ONE of the murkiest fronts in the war on terrorism was being tackled this week in Stockholm. As al-Qaeda and its affiliates continue to diversify their sources of money, choking off their financial lifelines has become a top priority. So experts from over 30 countries flew in for a brainstorming session.

The organisers, from an independent body called the Financial Action Task Force, say that regulating mainstream financial institutions no longer presents much of a problem. Instead, they are turning their attention to charities and to unregulated systems, such as *hawalas*, a popular method of transferring money in the Gulf and South Asia that leaves almost no paper trail.

The smaller the sums involved, the bigger the problem for the regulators. Anyone wanting to send up to $1,500 daily can do so anonymously. They can walk into a *hawala* broker in say, Karachi, and hand over the money in cash. The broker makes a phone call to the recipient's nearest *hawala* dealer, who simply pays him from his own account. It is all done on trust, handwritten records are kept but the money never moves through the banking system.

Before September 11th, al-Qaeda had no need for *hawalas*. It financed its activities through banks in Dubai and elsewhere, wiring lump sums to wherever it wanted. Now, it may be looking for more secretive channels.

Charities also offer a way. Islam requires every Muslim to make an annual donation equivalent to 2.5% of savings. The Saudis, who give generously—over $250m a year—are now regulating charities, banning them from sending money abroad without permission.

Other methods include money laundering, credit-card fraud and petty theft, all areas that Europe-based groups sympathetic to al-Qaeda are thought to have moved into in the past two years. The American Treasury, which chaired one of the Stockholm sessions, remains upbeat, citing the $135m that has been frozen worldwide in terrorist assets.

But terrorism of the al-Qaeda sort does not need a lot of money. The attacks on September 11th cost $500,000 at most. The attack on the *USS Cole* in Aden three years ago cost just $50,000. That's just one successful visit to a rich benefactor, who asks no questions and who pays in cash.

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**Rape in Kenya**

# Who did what to whom?

Oct 2nd 2003 | DOL DOL
From The Economist print edition

**Rape is always hard to prove. Especially when lots of money is at stake**

IT WAS a heart-rending scene. A hundred Masai women trekked to the British High Commission in Nairobi on August 14th, coddling 40 pale-faced children against their ebony skin and scarlet robes. They said they had been raped by British soldiers. Another 800 women, mostly from the Masai tribe or their Samburu cousins, are making similar claims. For the past 30 years, there has been an “epidemic of rape” by British troops on exercise in central Kenya, said Martyn Day, a British lawyer organising a civil action against Britain's Ministry of Defence.

Rose, a 26-year-old prostitute from the Indian Ocean resort of Malindi, says that the first she knew of the rally was when friends told her they had seen her two children among the marchers on the evening news. Far from being the offspring of a rape, she says, both were born after professional liaisons with Italian tourists. Rose's mother, who lives near Nanyuki, the British army's base in central Kenya, was accompanying them.

Last week, a British diplomat revealed that a six-month British investigation had found that the police reports supporting the women's claims had been forged. Local hospital registers also seem questionable, with the entries that detail the rapes typically scrawled at the very bottom of the page.

Confronted with Rose's claim, Mr Day admitted that he did not know all the children at the rally, but said all had been vouched for by their chiefs, making any deception nearly impossible. He stressed the physical evidence of some 60 mixed-race children, and the women's testimonies. He has heard 80 women's accounts so far, mostly through an interpreter.

Typically, the women claim to have been gang-raped by at least three British soldiers while herding goats or collecting water. Some say they were lured by their assailants with biscuits. Elizabeth Naeku, a 58-year-old alcoholic in Dol Dol, a nearby town, said she and a friend were raped at home by around six British soldiers. When she delivered a half-caste son, she said, her husband abandoned her.

Mr Day unearthed the rape allegations in 2000, while preparing a suit on behalf of hundreds of Masai herders blown up by ordnance left lying on firing ranges used by the British. Initially, around ten women claimed they had been raped. Then, Britain settled the munitions case for £4.5m ($7m), with some victims receiving hundreds of times the Kenyan average annual income. More alleged rape victims subsequently came forward. Mr Day says he is sure that most are sincere, and predicts that over 400 of their cases will be proved, implicating 2,000 British soldiers.

The British investigation is continuing. Mr Day is hoping to seek corroboration for his clients' claims from local elders and chiefs. He did something similar during his previous case against the British Defence Ministry, but some bogus claimants may still have slipped through the net. One Masai claims to have won compensation for injuries caused, not by British bombs, but by a hyena. Meanwhile, the 600 British soldiers resident in Nanyuki are confined to barracks, crippling the economy of a town that once depended on their carousing for its livelihood.

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**Côte d'Ivoire's war restarts**

# Kids with Kalashnikovs

Oct 2nd 2003 | BOUAKé
From The Economist print edition

**The problems are the same as ever, and now the shooting too**

SINCE Côte d'Ivoire's civil war broke out a year ago, the main rebel group has been surprisingly well-disciplined. Its stronghold, the northern town of Bouaké, has remained calm, without the need for a curfew. Rebel leaders have jovially invited the people of Abidjan, the government-controlled commercial capital, where a 7pm curfew dragged on for months, to come and party in Bouaké's night-clubs, which throbbed to a “revolutionary beat”. But now, the rebels' discipline is cracking.

The New Forces, as the rebels call themselves, were supposed to be part of a “national reconciliation” government, set up with French help in March. But on September 23rd, they pulled out—provisionally, they say—saying that they have been denied real power. True enough: out of 42 ministries, only 11, all run by President Laurent Gbagbo's party, have budgets.

AFP

**Have gun, will eat**

Two days later, renegade rebels tried to rob the Bouaké branch of the Central Bank of West Africa. The New Forces quickly stopped them, but then more young men with guns had another go, and by the weekend, the toll had risen to 23 dead and 37 wounded, many of them civilians crushed in a stampede for loose cash. French and Senegalese troops, who have been policing a ceasefire line that cuts Côte d'Ivoire in two, rushed in to keep the peace. But on September 30th, the shooting started again. Bouaké's frightened residents took cover, lamenting their increasingly desperate lot.

The northern half of the country is largely cut off from the more commercially vibrant south. Civil servants are paid late or not at all. Everyone is getting poorer, and the teenage rebels manning road blocks, often dizzy on pineapple hooch, are asking more insistently for *cadeaux*. “We can't eat our guns,” jokes one.

Despite French and African efforts to soothe all sides, the situation is volatile. The rebels have dropped all pretence that they are disarming. “The resumption of war is no longer a fantasy,” said Guillaume Soro, the rebel leader who is still, technically, minister of communications in the unity government.

Mr Gbagbo, who never liked having rebels in his cabinet, is making no effort to woo them back. He dismisses them as “kids with Kalashnikovs” and “houseboys using their master's swimming pool”, though they control half of the country. State television, even while Mr Soro was supposed to be in charge of it, has devoted much airtime to such insults, and to Mr Gbagbo's insinuation that the rebels are stooges of next-door Burkina Faso.

The rebellion's roots lie in the mistreatment of Muslim northerners by a succession of southern-dominated governments. Mr Gbagbo is a prime culprit. This week, he reiterated the need to enforce national identification laws, which have deprived many northerners of citizenship. Northerners living in the south complain of constant harassment. “There are police raids now every day in my area of town,” complained one. On October 2nd, Mr Gbagbo's favourite youth leader organised a patriotic rally, calling on the rebels to disarm. But even if they did, the country would still be unstable; many rebels have deserted but kept their guns.

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# Guest of honour

Oct 2nd 2003
From The Economist print edition

Robert Guest, our Africa editor, has won the Queen's English Society's Goodchild Prize for Excellent English, for his account of a trip on a Cameroonian beer truck published in our Christmas issue last year.

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Europe's constitution

# A little bit of editing—or will it end up in the bin?

Oct 2nd 2003 | BERLIN, BRUSSELS AND PARIS
From The Economist print edition

**Governments are likely to make only small changes to the draft of a new constitution for the European Union—but those may confuse matters more**

Get article background

IN FIVE months or so, the European Union will probably have a new constitution, agreed upon, with varying degrees of grumpiness and glee, by all 25 countries due to be members of the club next May. But that is not the end of the affair. At least six countries, and perhaps as many as a dozen, may have referendums before their governments ratify the document, as they all must before it comes into force. If just one or two little countries say no, they may be asked to vote again (as has happened before, with the Danes and Irish). But if several countries or a couple of bigger ones demur, then the whole process may have to start again—or the Union may, after a pause, offer a humbler treaty based just on those parts of the document that cause no offence. No permanent sacred scroll is yet in the offing.

But even before that, the EU's governments must agree on a text. A lot of painful bargaining still lies ahead. But they look likely, at a pinch, to find a compromise. The governments will gather in Rome on October 4th, along with those of the ten expected newcomers mainly from central Europe, at an “inter-governmental conference” (an IGC, in Euro-jargon) to start their hoped-for final deliberations.

The Italians, who hold the EU's rotating six-month presidency until the end of the year, are mad keen to seal the document in December in a grandiose new treaty of Rome, echoing the one in 1957 that got the European project going. They may just manage it. But a truly final agreement on the draft may not be clinched until March, which is just about the latest when lawyers can get the document in shape to reconcile it, in time for the new entrants, with thousands of pages of existing treaties that it will replace. Most important of all, it must be ready for elections in all 25 countries for the European Parliament in June.

The EU's heads of government have already got what they declared, at a meeting in Greece in June, to be a “good basis” for a new constitution. Its draft had been drawn up, over many months, at a convention in Brussels chaired by a former French president, Valéry Giscard d'Estaing.

There was much grumbling over the document. Some governments moaned that it lacked a truly federalist vision. Others worried that it went too far, for instance by giving the Union new powers in such

areas as criminal law. But most now think the draft so finely balanced a compromise—between federalists and anti-federalists, between old-timers and newcomers, and between small countries and big ones—that it would be dangerous to disturb it very much, for fear that the whole thing might tip over. The Germans, for instance, think that so broad a consensus was reached in the convention that any government wishing to fiddle with the text must find an alternative broad consensus—which is unlikely.

Certainly the EU's founding six—France, Germany, Italy and the smaller trio of Belgium, the Netherlands and Luxembourg—are dead against big changes. France is more open to clarifying amendments, for instance on defence and foreign policy, but it too wants to preserve the broad compromises. The three Benelux countries have hinted that, should others try to unpick some of them, so might they—for instance, to reconsider the new post of chairman of the European Council, which they fear may weaken the European Commission.

Yet those keen to adopt the text broadly unchanged are likely to be disappointed. The British seem to have conceded on certain matters: for instance, they will probably let a Charter of Fundamental Rights be included, along with some extra EU powers in justice and home affairs. But they still have their “red lines” to defend. They want more safeguards to ensure that all foreign policy and tax decisions are taken unanimously, despite provisions that some of them could one day be taken by majority vote. They wish to establish that the EU's proposed new foreign minister (a title many Eurosceptics would like changed), who will be in both the European Council (where governments are represented) and in the supranational European Commission, will not answer to the commission. And they want to be sure that no EU defence policy will undermine NATO.

## A row about an address

Defence was at one point likely to be the fiercest area of dispute. Britain and others were determined to change the text to make any EU military venture, under the unlovely name of “structured co-operation”, subordinate to NATO. The British vehemently oppose the plan, dreamt up by France, Germany, Belgium and Luxembourg, for a new and separate EU defence-planning staff to be set up at Tervuren, a Brussels suburb. Now, however, compromise is in the air: Britain will accept a separate EU planning unit so long as it is part of the existing defence framework. It may end up in the commission's Kortenberg building in Brussels, not in Tervuren.

The fiercest arguments now look likely to be over changes in the way the commission and council work. The smaller countries, including most of those from central Europe, have already met in Prague to set out their demands. Most passionately, they want the constitution to enshrine a right of every country to have a commissioner. Mr Giscard d'Estaing's text proposes that from 2009 the commission would have only 15 commissioners with a vote and another 15 without one. The smalls, backed by the commission itself, insist that each country should have a voting commissioner, even though a 30-strong commission would be unwieldy, wasteful and weaker.

Most big countries hint that they will give way on this score but not on the proposed new weighting of votes in the council, where the biggest countries would have more clout, partly in keeping with their population sizes. Spain and Poland are fiercely against a proposal in the draft for voting by “double majority”: that is, a decision would be taken if a simple majority of countries, comprising at least three-fifths of the EU's population, agrees. The Spaniards and Poles want to stick to the existing more complex system of votes, agreed three years ago in Nice, which gives them each the unduly high number of 27 votes, against 29 for Germany, even though Germany is twice as populous. The new constitutional draft in effect bolsters Germany. The Poles say they ratified their entry in the EU on the basis of the Nice treaty, so it should not be changed.

Because the constitution must be agreed unanimously, Poland and Spain may get their way, though the Poles will probably have to drop their demand for a reference in the preamble to God. Germany may yet try to force the Spaniards to give way by threatening to chop the funds they get out of the EU, in next year's budget negotiations—which, some Germans say, will be the EU's toughest ever.

Either way, expect a new constitution to be signed by the spring. But whether it will last without further changes, or ever come into force, is still an open question.

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France and Europe

# The rise of the Eurosceptiques

Oct 2nd 2003 | PARIS
From The Economist print edition

**The French are increasingly ambivalent about Europe—and their place in it**

TIME was, Europe served as a useful device for French politicians. It enabled them to impose unpopular reforms—privatisation, energy liberalisation, cuts to farm subsidies—in the name of a popular, greater European, good. But an increasingly prickly relationship between France and the European Commission has begun to produce an uncomfortable sensation: is French Euroscepticism on the rise?

AFP

**Those stars are getting blurry**

The immediate cause of the spat with the commission turns on the government's budget deficit for 2004. In the budget unveiled last week by Francis Mer, the finance minister, France plans in 2004 to exceed the 3% limit imposed by the European Union's stability pact for the third year running, this time reaching 3.6%. Despite scolding, France says it will not make further changes to bring the deficit into line by October 3rd, as requested by European finance ministers. They must then decide whether to start the procedure for punishing France, which could end in a fine. The irritation in Brussels (see article) is palpable: the French understanding of rules, goes a widespread feeling, is that they apply to everybody else.

For their part, the French are exasperated by what they regard as a narrow-minded Brussels obsession with such rules and an inflexible disregard for the broader picture. The government of Jean-Pierre Raffarin, the prime minister, has bent over backwards in the past month, argue its officials, to bring the deficit under control. Yes, it has been clumsy and careless in its choice of words, declaring breezily that France had other priorities than controlling the deficit (Mr Mer) or solving mathematical problems to the satisfaction of others (Mr Raffarin). But it has delivered a budget that freezes spending and reduces the structural deficit by 0.7%, not far off the 1% cut that EU finance ministers wanted.

France feels bossed about by Brussels in other ways too. The commission threatened, for instance, to block the government's recent bail-out of Alstom, an engineering group, approving a rescue plan only after France agreed to last-minute changes. It is now demanding the over-due repayment of loans the government made last year to Bull, a computer group.

On top of this, French unease about the implications of the EU'senlargement is growing too. The fear is that a Europe of 25 will turn into little more than an economic zone, less glued together politically, and in which France will struggle to retain its traditional influence as Germany looks east. The French are the most hostile of all EU nationalities to enlargement, with only 31% in favour and 54% against, according to Eurobarometer's poll last spring. This disquiet has fed into a general French glumness, reflected in a recent clutch of much-discussed books (see article). “Europe is no longer, or less and less, seductive,” laments a recent editorial in *Le Monde*.

The upshot of all this is threefold. First, and in the short run, the French government is trying to persuade the commission that it is in its own interests not to fan Euro-hostility by imposing further spending cuts for 2004. “We need Brussels to understand”, says one official, “that Europe as an idea will suffer if they insist.” Whether or not the commission buys this, the strategy of using Brussels to enforce domestic French reform may have run its course.

The second is a deepening ambivalence about the wisdom of holding a referendum on the EU's new constitution. In the past, President Jacques Chirac has promised that it would be “ratified by the people”.

This view has now been softened to simply a “preference” for a referendum. The blunt realisation is taking hold that the French might well say no.

French scepticism is far weaker than in Britain, where only 30% now say EU membership is “a good thing”, next to 50% of the French and 54% in the Union as a whole. But support has slipped from a year ago. And nobody forgets that the French approved the Maastricht treaty by only a bee's whisker. Moreover, the ruling Union for a Popular Movement is divided over the matter—as is the opposition Socialist Party. There would be plenty of sceptical voices in any referendum campaign.

The third upshot is a reinforced sense of urgency within the Elysée over the need to forge ahead with a “pioneering group”, to use Mr Chirac's preferred term. Officially, the point is to strengthen the heart of Europe, in areas such as defence, among those countries that wish to participate. But the project is also an attempt to preserve French influence in an enlarged Europe and to fortify Europe as an alternative hub of power to the United States.

It is unclear whether any of this, even if feasible, will stem the Euro-disaffection in France. Do the French really want “more Europe” as a response to their growing disillusion? Perhaps, if the outcome is renewed French influence. Mr Chirac's stand against the war in Iraq was hugely popular in a France that feared it had lost its global voice. Yet the risk is high. According to polls, those most worried about enlargement are the elderly, those in north and eastern France, and the least educated: precisely the recruiting ground for France's most Eurosceptical politician of all, the far-right National Front's Jean-Marie Le Pen.

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Germany's reforms

# Let's slash together

Oct 2nd 2003 | BERLIN
From The Economist print edition

**The leaders of two states, from opposing parties, show the way**

CUTTING subsidies can be harder than raising taxes, particularly in Germany, where financial aid and tax breaks together add up to an estimated €157 billion ($182 billion) a year—more than a third of all tax revenue. And it is even harder to get government and opposition to agree on how and where to make such cuts.

Yet this is exactly what could now happen. For the first time since the second world war, Germany may be seriously examining its chunks of pork. On September 30th, the premiers of the states of North Rhine-Westphalia (Peter Steinbrück, a Social Democrat) and Hesse (Roland Koch, a Christian Democrat) jointly presented a proposal that could save government coffers €15.88 billion in three years. More remarkably, they received general applause.

The pair pulled it off not by trying to cut specific items, knowing that that would lead to endless debates over which subsidies are good or bad. Instead, they decided to apply a method which they liken to a lawn mower: except for aids deemed “sensible” (such as support for health care, charities and research), they want all federal subsidies cut by 4% a year for the next three years.

That is a lot—but may still not be enough, given Germany's sorry public finances, which are heading for a deficit this year of at least €67 billion. Hans Eichel, the finance minister, has already said he wants to go further, for instance by sharply reducing home owners' support and commuters' tax breaks.

The blueprint has another weakness: by cutting evenly across the board, it avoids tough political choices. Radical reformers ask why, for instance, the government should give people money to buy a house or get to work at all? Still, Messrs Steinbrück and Koch at least came up with a detailed list of who is getting what and a tool box for working out further cuts.

It would in any event be good for Germany if the blueprint was put into practice. It might also help the chancellor, Gerhard Schröder, who this week again threatened to resign if left-wing rebels among his own Social Democrats in parliament refuse to back his ambitious reforms. To push them through, he must strike deals with the opposition. The two premiers' subsidy-cutting proposal shows that a consensus is possible without all good ideas, as they put it, “being ground to death”.

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The pope

# Who will follow him?

Oct 2nd 2003 | VATICAN CITY
From The Economist print edition

**The ailing pope, John Paul II, is trying to secure a conservative succession**

Get article background

AP

**The spirit is willing...**

IT WAS the clearest sign that his end is near. First, Pope John Paul named a batch of 31 new cardinals, including his in-house theologian and seven prelates who have worked alongside him in the Vatican. Then he elevated to archbishoprics his secretary, the head of the pontifical household and his master of ceremonies. And the next consistory, the cardinals' council, was hastily brought forward to this month.

In his 83 years, Karol Wojtyla has been run over twice, shot by a would-be assassin, and had a malignant tumour removed. His survival is a triumph of the spirit. His main known ailment is Parkinson's disease, which can make sufferers look and sound worse than they feel. But his announcement to the crowd in St Peter's Square was painful to behold. His speech was so slurred that many of the new cardinals' names were unintelligible. He muddled a date. After every few words he paused to give a heaving sigh.

All of which makes his latest appointments particularly telling, for the new cardinals' college will probably be the one to choose the next pope. After this month's consistory, there will be 195 cardinals but only 135 with the right to vote. Ironically, given John Paul's own age, only cardinals below the age of 80 may do so.

Also excluded is a new cardinal whose name the pope is keeping secret—*in pectore* (in the breast), to use the Latin term. Such appointments are made when the individual's safety or Vatican diplomacy might be endangered if his identity were known. Most observers think the unnamed cardinal is Joseph Zen Ze-kiun, Hong Kong's archbishop, who said on a recent visit to Rome that China's communist authorities were extremely touchy because of simmering disloyalty to the regime in the “official” church they created to keep a grip on Catholicism.

The cardinal-electors' geographical origin still reflects, if less than before, the rich world's control of a church that increasingly finds its believers in the poor world. There are 66 European and 14 North American cardinals, against 24 Latin Americans, 18 from Asia and Oceania and 13 Africans.

What unites those who will choose the next pope is that all but a tiny number were appointed by the present one. Most of them, like him, are theological conservatives while sensitive to social justice. It is hard to see them choosing a liberal. But they may be tempted to go for an intensely spiritual figure as a unifier, like the pontiff's short-lived predecessor. John Paul is also intensely spiritual; but he has been a fighter and a centraliser, weakening bishops' power to run their dioceses as they choose. The real argument inside the church has been about the march of centralisation, not just a battle between so-called progressives and the conservatives who got the upper hand some time ago.

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Turkey's reform

# A worrying hiccup

Oct 2nd 2003 | ANKARA
From The Economist print edition

**A court decision is threatening to undermine Turkey's ambitious reforms**

AFTER ten months in office, Turkey's first single-party government in 16 years has made a splendid start in its effort to reverse decades of corruption, economic mess and authoritarian abuse of power. Inflation and interest rates have dropped sharply, earning the prime minister, Tayyip Erdogan, and his ruling Justice and Development Party glowing plaudits from Turkey's vital benefactor, the IMF. A report due out this month by the European Union on Turkey's progress towards meeting the criteria to let it start negotiating to join the EU is likely to be the most laudatory since Turkey formally asked to join the club 16 years ago. But all this progress could come to a bad-tempered halt, thanks to a recent ruling by a Turkish appeals court.

The reason the judges may have thrown a spanner in the works (and, by the by, caused the markets to dive) is that they have upheld the convictions of four members of a mainly Kurdish party, previously sentenced to 23 months each for forging registration documents before last November's general election. Under Turkish law, a party must show it had offices in more than half the country's 81 provinces at least six months before an election in order to stand. The Democratic People's Party, known as Dehap, said it had 63 offices when, according to the prosecution, it had only 27. Some 2m voters, mostly in the Kurdish south-east, plumped for Dehap, but that was not enough for it to cross the national threshold of 10% of votes cast to win seats in parliament.

The court's decision has created such dismay among reformers because, if all Dehap's votes are ruled invalid, the ensuing redistribution of votes would mean that the conservative True Path party, which fell just short of clearing the 10% hurdle, would get into parliament after all. That might deprive Mr Erdogan of his overall majority in parliament, making it much harder for his government to force through its ambitious array of reforms. It would certainly deprive him of the two-thirds of seats (which he almost has) needed to change the constitution—and, among other things, overhaul the judiciary.

The current parliament, dominated by the mix of Islamists, liberals, nationalists and Kurds in Mr Erdogan's party, has approved a slew of revolutionary reforms. They include diluting the influence of Turkey's powerful generals and letting the country's 14m Kurds broadcast in their own tongue and teach it (though not have all lessons in it) in private schools.

The generals and the old-style secular parties would still love Mr Erdogan to trip up. They despise him for his Islamist past, which he now tends to disavow. And they resent his tightening grip on power. Indeed, Mr Erdogan's supporters suspect that some of his detractors' friends on the electoral board allowed Dehap to run even though they knew its faulty paperwork could disqualify it, because they hoped that it would take votes away from Mr Erdogan's lot in the Kurdish parts of the country, where both parties are strong.

Still, if the recent court verdict means shaking up parliament's composition to Mr Erdogan's detriment, he could ask the president to call another election—and his party might well win even more handsomely than before. Last time round, it won 35% of votes cast, almost twice the score of the secular-minded Republican People's Party, the only other one to win seats in parliament. Pollsters say that if an election were held today, Mr Erdogan's party might get 40%, probably enabling it to alter the constitution on its own. So the electoral board may yet decide to uphold the election result—and let Mr Erdogan keep his thumping majority in parliament.

In any event, Mr Erdogan might be wise, as part of his reforms, to lower the national barrier of 10% so that the many Kurds who want to vote for Kurdish parties are not, in effect, disenfranchised.

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Serbia

# An odd choice of peacekeeper

Oct 2nd 2003
From The Economist print edition

**Serbia's offer to send gendarmes to Afghanistan may raise eyebrows**

Reuters

**From cosy Kosovo to cool Kandahar**

IF YOU can't beat them join them. The last time Serbian soldiers had serious negotiations with American ones was when they surrendered their province of Kosovo after the Americans had bombed them for 78 days. In recent weeks, however, senior officers from the army of what is now the loose union of Serbia and Montenegro have been in the United States to discuss sending as many as 1,000 men to fight alongside the Americans in Afghanistan.

No details have been announced, except that the men will probably be deployed around Kandahar, the old stronghold of the Taliban regime that was overthrown two years ago, again thanks to American bombing. Because these men must be the best that Serbia has to offer, they will come not just from the ranks of the army but also from an elite paramilitary police force, the gendarmerie.

After nearly a decade of war in former Yugoslavia, many of these men have a lot more experience of fighting than their new-found American friends. But, while the Americans will welcome the muscle they will bring to the fight against the Taliban and al-Qaeda, they may not be so keen on the bad press likely to accompany them in the Muslim world. For many of these men will have fought against Bosnia's Muslims and Kosovo's overwhelmingly Muslim Albanians, and may well have been involved in “ethnic cleansing”.

Indeed, the head of Serbia's gendarmerie is General Goran (“Guri”) Radosavljevic (right), who is tipped to lead the force in Afghanistan. He and his men have been widely accused of atrocities in Kosovo but he has always denied them and has not been indicted by the UN's war-crimes tribunal in The Hague. But Natasa Kandic, Serbia's most prominent campaigner against war criminals, says that the general should not even still be a policeman in Serbia, let alone be considered for service abroad.

Serbia's parliament has yet to approve of the deployment but so far the idea has stirred little controversy bar some bitter suggestions that the Americans who bombed them should now stew in their own juice. Many men sound keen to go. But the people most worried are those who are supposed to secure southern Serbia against increasing attacks from extreme ethnic-Albanian nationalists. Such Serbs fear that pleasing America by sending their finest to Afghanistan may leave the country vulnerable to yet more Albanian attacks.

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**Charlemagne**

# Don't mention the euro

Oct 2nd 2003
From The Economist print edition

### The euro's deficit rules are apparently unenforceable yet unchangeable

**Get article background**

WHEN the prime ministers and presidents of the European Union assemble in Rome on October 4th to start discussing a new constitution for the EU, they will be preparing to do battle on many issues: the relative voting power of countries in the Union; the future of European defence policy and criminal law; the place of religion in a declaration of European values. But one element of the draft that will very probably be nodded through without much ado is Article III-76, on “excessive government deficits”, along with its associated protocol, which lays out a number of fiendish punishments for countries that run budget deficits of more than 3% of GDP.

The excessive-deficit procedure already exists in European law and is being put into the constitution, with minor modifications. This is a very peculiar state of affairs. No less an authority than Romano Prodi, the head of the European Commission, has called the current rules “stupid”. The governments of France, Germany and Britain have all made it clear that they think they should be made more flexible. The whole thing has been falling apart anyway, as France and Germany have repeatedly breached the 3% limit. The drafting of a new constitution would have provided an ideal opportunity to change the rules and make them more realistic. Instead, the entire cumbersome procedure is being set in the stone of constitutional law.

The problem may sound technical but has profound political implications. The excessive-deficit procedure embodies the fundamental political issue facing the EU: how much sovereignty are countries truly prepared to hand over to Brussels? In normal circumstances, when the finances of the 12 countries that have adopted the euro are not heavily in deficit, the handover is not too evident. But when the excessive-deficit procedure kicks in, it becomes (at least in theory) very intrusive indeed. The Union has the power to issue binding recommendations to countries that repeatedly violate the 3% rule. Rather like the International Monetary Fund, it can order countries to raise taxes or cut spending. If countries fail to comply with the IMF, funds are withheld. But the EU can go even further by slapping fines of billions of euros on malefactors. However, while EU countries have agreed to this sanction in theory, they show little sign of being able to live with it in practice. Jean-Pierre Raffarin, the prime minister of France, the country most at risk of being fined, has spoken irritably of not bowing to the wishes of pen-pushers in Brussels.

So why is the Union now intent on incorporating this unworkable piece of legislation into its constitution? The problem is that, while most people can agree that the current procedures are not working, there is no consensus about how to change them. A few dissident voices, including *The Economist*, have argued that the European single currency does not actually need rules constraining government deficits at all, since the markets can punish governments that borrow irresponsibly.

But this is not an argument that finds much favour within the EU, where most governments still fear that an excessive deficit in one country will inevitably hurt others in the euro area. Instead there is a camp of reformists, which coincides suspiciously with the countries that are finding it hardest to stick to the rules. They argue that the current procedures should be made “more flexible”. Perhaps the definition of the “exceptional circumstances” in which countries can run large deficits could be made more forgiving. Perhaps special rules could be drawn up so that “investment spending” is excluded from the deficit measure. Or perhaps more attention should be paid to overall government debt rather than annual deficits. All interesting ideas, but, alas, there is no consensus in the EU to act upon any of them. Besides, the leaders of several EU countries have repeatedly assured their electorates that the rules on deficits are, in the words of Guy Verhofstadt, Belgium's prime minister, “our bible”, thus making it impossible for them to agree to any changes.

The result is that the excessive-deficit procedure will be incorporated into the constitution and will then gradually fall apart in a rather agonising and public fashion. A further twist in this process was due to take place on October 3rd, just a day before the leaders of EU countries were to gather in Rome. That was when France was meant to tell its European partners how it had responded to recommendations made to it earlier this year to help bring its deficit under control. The short answer is that the government in Paris has blithely ignored these suggestions. The next step is for the European Commission to suggest binding recommendations. If these are then ignored, the first moves towards fining France could take place in January. Keen to avoid so drastic a step, the European authorities seem more inclined to let France break the 3% limit again in 2004 but to demand a few further tokens of budgetary consolidation and to hold the French to their promise to come back below 3% in 2005.

## What a sham, what a mess

If the French do indeed return to fiscal discipline in 2005, a full-scale euro-crisis might be avoided. But France's deficit projections have consistently been too optimistic in the past, so there is good reason to expect that they will break the 3% limit for the fourth successive year in 2005. At that point, fines could finally be voted through, with potentially horrible consequences for France's relations with the EU.

More likely, however, the countries that would have to vote for the fines will balk at the consequences—and the fiscal rules governing the euro will finally be exposed as a sham. Unfortunately, by that time, the whole excessive-deficit procedure will probably have been incorporated into Europe's constitution, which could only be amended unanimously by all 25 of the Union's current and future members. So the EU's fiscal rules will be simultaneously unenforceable and unchangeable. Precisely the kind of mess that tends to bring constitutions into disrepute.

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Public spending

# Gordon feels the strain

Oct 2nd 2003
From The Economist print edition

**The chancellor's next spending review will be difficult**

BRITAIN'S public services have never had it so good. Public money set a lavish table for them in 2000, and they have been gorging themselves ever since. The good times may roll on until the next election, due by mid-2006. But then it will be short rations for all but a favoured few.

That was the hidden message of Gordon Brown's speech to the Labour Party conference this week. The headlines billed the speech as a thinly disguised attack on Tony Blair's leadership. But as important was what the chancellor of the exchequer had to say about the Treasury's approach to the next spending round, which will fix departmental budgets in the years ahead. Mr Brown promised to “lock in” spending increases already planned until 2005-06 and to deliver additional resources beyond that, financed in part by savings in bureaucracy and efficiency reforms.

That was the giveaway line. Efficiency gains are the time-honoured hope of chancellors who can't make their sums add up. Mr Brown's previous spending reviews were conducted from a position of immense fiscal strength as the public finances swung into huge surplus in the late 1990s. But the new review, which will be completed next summer, starts from a position of increasing fiscal weakness.

Figures released this week show that in the first quarter of this financial year, the government borrowed an astonishing £15.4 billion ($24.7 billion), the second-highest figure on record. The Treasury expects a budget deficit of £27 billion, or 3% of GDP, this financial year; but a survey of independent forecasters shows an average prediction of £32 billion. The chancellor thinks the deficit will narrow to just over £20 billion in the years ahead. But PWC, an accountancy firm, thinks it will widen to £40 billion by 2005-06 (see chart).

This is the bleak background for the spending review, which divides the available money among the hungry mouths of the public services. It fixes about 60% of total government expenditure; the rest comprises payments set annually, primarily social-security benefits and debt interest. With plans already set until 2005-06, what is at stake are departmental budgets in the two ensuing years, 2006-07 and 2007-08.

The chancellor laid out some crucial projections for the next few years in his spring budget. Annual growth in total government expenditure will slow from 4.5% in the three years to 2005-06 to 2.8%—still higher than the assumed rate of economic growth of 2.5%—in the following two years. The 40% portion set annually will continue to grow by 1.75% a year, in line with recent trends.

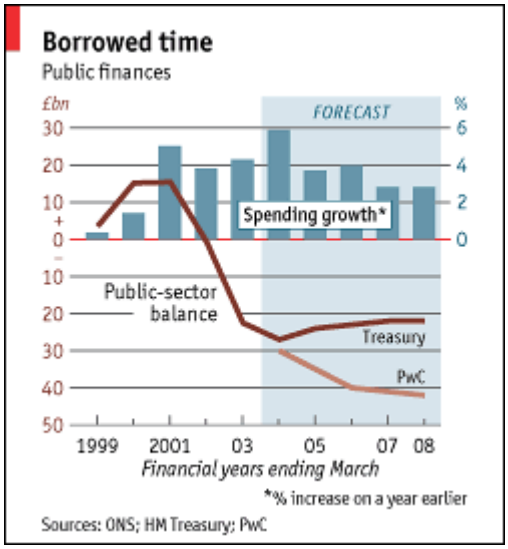
On the face of it, that leaves a fairly substantial increase of 3.5% a year in 2006-07 and 2007-08 for departmental budgets. The trouble is that one hungry mouth has already gobbled up much of the money available. In 2002, Gordon Brown made not a three-year but a five-year settlement for health, so that in 2006-07 and 2007-08, real resources going into the NHS will continue to race ahead by over 7% a year.

Strip this money out of the kitty, and the growth available for all the other public services falls to less than 2% a year, nearly half the rate of expansion in the current spending round. But then there is that other favoured candidate, education, asking, Twist-like, “Please Sir, can I have some more?” For a government that has made so much of its commitment to schools, it would be

unthinkable to impose a sudden squeeze on education spending. Yet if it continues at the current annual growth rate of nearly 6%, there will have to be a freeze on all other departmental budgets.

No extra money for transport despite the disgrace of Britain's roads and trains? No more resources for defence, even though the armed forces are at full stretch and the extra money assigned for the Iraq conflict is almost all spent? No extra cash to police the streets? That is hardly the stuff of generous Labour promises.

Enter the *deus ex machina*, those efficiency gains. These, an aide to the chancellor claims, could raise billions of extra money for front-line services. Suppose—implausibly—that as much as £5 billion can be released in this way. Around £1.5 billion would go to help Mr Brown meet his ringing commitment to reduce child poverty, calculates the Institute for Fiscal Studies. That would leave only enough to deliver a stingy annual increase of 1% for all the public services save health and education.




At the last election, the healthy state of the public finances meant that Labour could promise big spending increases without arousing fears of swingeing tax increases. At the next election, Labour will have much less to offer in spending increases. And with the public finances so heavily in the red, few people will doubt that there will be a post-dated tax demand coming their way. But that's what happens when the menu's offerings are grander than the larder's contents.

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About sponsorship

Growth

# The new old economy

Oct 2nd 2003
From The Economist print edition

### Statistical revisions boost growth

WHEN Gordon Brown forecast that the economy would grow this year by 2-2.5% in his April budget, many economists were sceptical. Now the chancellor looks as if he may get the last laugh.

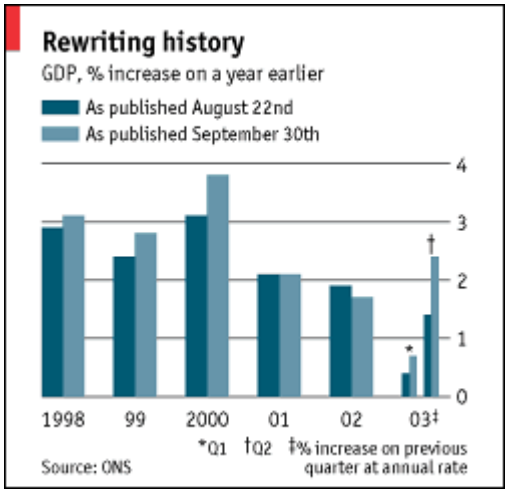
The Office for National Statistics (ONS) released new figures this week that show the economy was doing much better in the first half of the year than had been thought. Growth in the first quarter compared with the previous three months has been revised from an annual rate of 0.4% to 0.7%; and in the second quarter from 1.4% to 2.4%, about the trend rate of growth. With signs of a strong third quarter, growth in 2003 could reach around 2%.

It is not just this year's figures that have been revised. The ONS has been combing through its numbers for GDP in previous years, revising them to take account of new information, changing its estimates of prices and updating the weights it uses to combine series.

A click of the statistician's mouse has achieved what Gordon Brown has been so keen to produce: a faster growth rate. In the five years to 2002, GDP grew by 2.7% a year, rather than the previous estimate of 2.5%. Much of the improvement occurred in 1999 and 2000, when the economy grew by 2.8% and 3.8% respectively, compared with earlier estimates of 2.4% and 3.1%. Set against this, growth in 2002 has been revised down a bit, from 1.9% to 1.7%.

The new figures are a mixed blessing for the chancellor. Evidence of more robust growth this year makes it harder to blame recent weakness in tax receipts on a slack economy. “Since the economy has been performing better it suggests the shortfall in receipts is structural,” says Christine Frayne of the Institute for Fiscal Studies. Similarly, the cyclical strength of the economy must have contributed to past budget surpluses.

There is a sting in the tail for homeowners, too. Now the economy has turned out to be stronger, interest rates are likelier to rise before long.

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NHS and innovation

# Healthy profits

Oct 2nd 2003 | EDINBURGH
From The Economist print edition

## Making money out of the health service

Get article background

THE National Health Service, British socialism's proudest offspring, has never wanted much to do with profit-making ventures. Now that's changing, as a result of new rules on exploiting inventions.

Since last year, the government has allowed hospital trusts and other health service bodies to hold shares in companies set up to exploit a discovery. It has also set up state-owned companies to protect and transfer the intellectual property rights of NHS discoveries to manufacturers and spun-out companies. As with universities, which have been doing this kind of thing for some time, the idea is that both the inventor and the NHS should earn money while improving patient care, and the economy should benefit too.

The potential from this is huge. Tony Bates, an NHS intellectual property adviser, reckons that with 1.3m staff working on better ways of treating people, the NHS is Britain's largest untapped source of intellectual property. Past failure to protect these rights, he says, has been costly. He thinks that failure to patent improvements to equipment is partly why British medical engineering firms' share of the world market has fallen from 20% to less than 2% in the last 50 years. He cites examples of doctors discovering that a drug for one condition can be used to treat another, then being forced to stop using it for the new treatment until the NHS pays the manufacturer for the right to use it in a new way. Such discoveries, he says, can be patented. That would allow the NHS to reap royalty payments, at the same time as ensuring that medical care is not interrupted.

In the first year of this new regime, the NHS has earned about £500,000 ($830,000) from about a dozen inventions or new techniques. There is, American experience suggests, plenty of scope for more. One American hospital alone—Massachusetts General in Boston—has an annual licensing income from its doctors' discoveries of $30m. In 2002, the hospital reckoned it made 213 discoveries, filed 104 patents, and spun out four companies.

British doctors are just as inventive. Cameron MacDonald, chief executive of Scottish Health Innovations, the company managing health service discoveries north of the border, says he has had more than 100 proposals from NHS staff. “Some are ill thought-out and have been rejected, but clearly there is a lot going on that we have yet to uncover,” he says.

One promising spin-out company is Tayside Flow Technologies, the product of work by three doctors specialising in treatment of vein disorders at Ninewells Hospital, Dundee. Existing artificial veins used in leg grafts have a high failure rate, often necessitating amputation. The doctors discovered that if an artificial vein produced the spiral blood flow of natural veins, rather than a straight flow, the failure rate could be reduced.

The company, which hopes to make veins for a global market estimated to be currently worth $300m, has recently raised £1.3m from private sources aimed at starting clinical trials of the new veins in 2004. Though the taxpayer may eventually benefit from royalty payments to the NHS, about £500,000 of public money was needed for development work to convince private investors. This implies that, if the government is to make a lot of money out of doctors' ideas, the NHS's research budget may have to be a lot bigger than its current £343m. Or the government could, of course, privatise health care.

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**Supermarket competition**

# A four-power world

Oct 2nd 2003
From The Economist print edition

**That's what the regulators want. Will Sainsbury's ensure it stays that way?**

LUCKY Sainsbury's. Experts said it was the loser from the ministerial decision on September 26th to ban the big three of British supermarketry—Tesco, Asda and itself—from buying the fourth, Safeway. But the experts may well be wrong, to the benefit of shoppers and shopkeepers alike.

In January, the fifth-biggest supermarketer, the successful northern chain of Wm Morrison, had won Safeway's agreement to a takeover dressed up as merger. That prompted the big three chains to talk of bidding. The competition authorities were bound to be called in.

Parts of the resulting decision were predictable. Tesco, the heavyweight of the sector, had no chance of getting the go-ahead. Barely likelier was fast-growing Asda, also strong in northern England and owned since 1999 by the American giant Wal-Mart. Nor yet was J Sainsbury (to give it its official name), the one-time market leader. And so it proved: in a six-month, 500-page study of the supermarket world, stuffed with fuzzy logic and isochrones (don't ask), the Competition Commission concluded what the rivals' market shares already indicated, that only Morrison would be allowed to bid.

That will take time. First Morrison, “in good faith”, must agree to sell 53 specified Safeway stores—it has 481—or nearby ones of its own, to buyers, at prices and on conditions (two pages of them) acceptable to the Office of Fair Trading. Even then, Safeway shareholders could kick up trouble, dismayed—they are moaning already—to see the enriching rough-and-tumble of a takeover battle replaced by regulated monopsony. But in the end, unless a fresh bidder turns up, the likeliest result is a four-power supermarket sector: Tesco with a third of sales, Asda, Sainsbury and Morrison/Safeway with about a fifth apiece, plus a few tiddlers struggling in the remaining 7-8% of the market.

The real doubt now is about the future of Sainsbury's, the faded *grande dame* of British grocery. This topic has been retail analysts' favourite talking-point, all the more so this week, with the scuppering of the firm's hopes of a link with Safeway. Yet that failure was arguably the best thing that could have happened to it. Sainsbury's talk of a bid for Safeway was not just window-dressing, it says; and in mid-summer it was talking of buying 171 stores from another small outfit, Somerfield. This too was swiftly referred to the regulators; and that again was probably a good thing.

Sainsbury's has plenty of space. What it is short of is sales and profits. Under Sir Peter Davis, its chief executive since 2000, it has spent heavily on improving its rickety supply chain and bolt-on IT systems; it is moving into the higher-margin non-food sales that have done well for its competitors. Yet it is still struggling to manage even what it has; would it do better if it added the hassle of integrating 171 new stores to its estate, let alone 481 and their shop-soiled management on top?

Sainsbury's bosses and shareholders can only benefit by being saved from their own expansive ambitions. And the firm's welfare matters more widely, to British shoppers at large. Rightly, the Competition Commission thinks households should have access, where possible, to four rival supermarkets. A four-power struggle in which one contender of the four can neither land nor take solid blows is no lasting way to achieve that.

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**Wild swimming**

# Don't be so wet

Oct 2nd 2003
From The Economist print edition

**Swimming in cold ponds in the dark is odd but should be allowed**

AT 7am each morning, a bunch of hardy Londoners enjoys a swim in the ponds on Hampstead Heath. The water is cold and silty. It is dark in winter; sometimes you have to break the ice.

Mad, perhaps. But is it dangerous? The Corporation of London, the local-government body that administers the ponds, thinks so. Citing legal advice, it wants the early-morning swimming to start a bit later, and may ban it altogether when ice-breaking is involved. That has sparked a furious row and a legal challenge, highlighting both the bracingly eccentric leisure habits of some Britons, and how safety-minded officials make life a lot duller.

The bureaucrats are scared of lawsuits. If, say, a lifeguard drowned trying to rescue a swimmer, they would be liable. The Health and Safety Executive, a powerful quango, could prosecute them, perhaps jailing the Heath's superintendent. Better, then, to shave the opening times in winter.

Not the point, say the swimmers. The danger is minimal—there has never been an accident among the early morning lot, let alone a fatality. And the seemingly trivial change is a serious loss. Only a 7am start allows them to swim before going to work, typically to high-powered jobs in central London (although one of their number, in a suitably eccentric touch, drives a rag-and-bone cart).

That raises the really interesting issue: why can't adults decide how much risk they want to bear? The swimmers want “self-regulation”, meaning that they would dispense with the early-morning lifeguard, and sign waivers absolving the authorities of responsibility for what happens. That seems fair enough: nothing stops people swimming in rough seas if they want to. So why should a pond in a park be different?

The law makes such a common-sense solution all but impossible. The Hampstead ponds count as a “managed facility”—meaning that officialdom bears responsibility for them. Someone must therefore be in charge, not just to rescue swimmers in distress, but also to advise novices of the dangers involved.

The swimmers have taken legal advice. A recent decision by the Law Lords, that a council was not liable for an accident suffered by a foolhardy swimmer in a municipal pool, strengthens their case. But the safetycrats are implacable. An activity may be safe for expert participants, explains Peter Cornall, head of water safety at the Royal Society for the Prevention of Accidents, but still send a dangerous signal to outsiders. In other words, rules must be drafted to make sure no nitwits drown themselves in frozen ponds, rather than to allow otherwise sensible people to enjoy being cold and wet in the dark.

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Railways

# Anyone know how to run a railway?

Oct 2nd 2003
From The Economist print edition

**Improbably, things still seem to be getting worse**

Alamy

Get article background

FIVE years ago, Britain's privatised railways were labelled “a national disgrace” by the deputy prime minister, John Prescott. Since then, despite billions of pounds of expenditure and a doubling of costs, performance has deteriorated. In 1999, the year prior to the Hatfield crash, 7.6m minutes were lost in delays. Last year, the figure was 14.7m minutes.

Many reasons have been advanced for this sharp decline, notably the need to renew the network as a result of a review of safety following Hatfield. But the government's patience with its not-for-profit creation, Network Rail, which took over the running of the network a year ago, appears to be running out. For some weeks officials have been talking to Network Rail's board about a shake-up which would involve recruiting a high-level executive with experience of running a railway.

The Strategic Rail Authority (SRA), which manages the railways for the government, has publicly indicated its unhappiness with the lack of progress. Richard Bowker, the SRA's chairman, said recently he was dissatisfied with what he called Network Rail's “current unacceptable levels” of performance. The SRA took the unusual step on publication of its latest punctuality figures of noting that Network Rail's recent performance had got worse.

The privatised train operating companies (TOCS) are so dismayed by the continuing problems that they have begun to speak openly about taking legal action. “We will bend over backwards to help Network Rail to perform,” says Graham Eccles, head of rail at Stagecoach. “But at the end of the day if they don't deliver on their contract with us, we will have to take action.” Private discussions have been going on between the train operators and the rail regulator, Tom Winsor, who has the power to take enforcement proceedings against Network Rail. But as any fine would be paid by the Treasury, it is hard to see what this would achieve.

Two can play the blame game. Train operators are responsible for almost half the delays on the network. But Stewart Francis, chairman of the Rail Passengers Council, points out that while the train operators' performance is nearly back at pre-Hatfield levels, Network Rail's is not, and it continues to deteriorate. Network Rail's chief executive, John Armitt, says that he and his board had always made it clear that it would take 18 months to show a noticeable difference in performance and three to five years to produce

sustainable improvement. “The blame game is totally unproductive,” says Mr Armitt. “I don't go round shouting about the TOCS.”

One of the underlying causes of the network's bad performance is the time taken to recover from routine failures, such as in signalling or track. This has increased by 70% since the Hatfield crash. The reasons for this are not fully understood, but congestion and safety are major factors.

Though one train operator, Go-Ahead, has called for dismembering the network into four or five regional companies, there is little enthusiasm in the industry, and none in government, for further fundamental upheaval. But unless Network Rail begins to perform, heads will roll.

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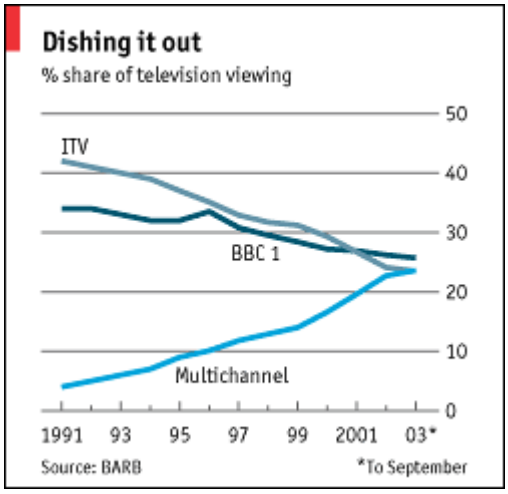
ITV merger

# Let the battle begin

Oct 2nd 2003
From The Economist print edition

**Next week's decision on an ITV merger will start a long-awaited showdown**




NEXT week the government is expected to announce a decision that could transform the future of ITV, Britain's troubled commercial broadcast TV network. ITV was originally made up of 15 separate parts, but now Carlton and Granada own 11 of them. Last year these two announced a plan to merge and unite ITV. The merger as planned, however, meant that ITV would control over half of Britain's advertising market. It was referred to the Competition Commission, which reached its conclusions over a month ago. As soon as the news can no longer distract from the Labour Party's conference this week—an unfair political delay, says an executive close to the merger—Patricia Hewitt, secretary of state for trade and industry, will announce her decision.

Michael Green, chairman of Carlton, and Charles Allen, chairman of Granada, dislike each other, having spent years trying to undermine each other inside the ITV network. Their employees, too, have learned to see the other ITV firm as the enemy. But because Mr Green and Mr Allen have made a hash of running their respective companies recently, they desperately need to merge in order to make cost savings and improve profitability.

ITV's long-term and probably irreversible problem is that it is steadily losing viewers. In 1983 it had nearly half of the British TV audience and now has a quarter. The main reason is the growth of multi-channel TV—satellite, cable and digital terrestrial—which since its birth has taken a fifth of viewing share. The growth of Channel 4 and Channel 5, and the strength of the BBC, with its generous public funding, have also contributed. Then Mr Allen and Mr Green lost about £1 billion on ITV Digital, a new service that was switched off last year. Greg Dyke arrived at the BBC and stole ITV's viewers with aggressively commercial programming. To cap it all, a cyclical low in advertising revenues put pressure on programming budgets.

How much good would a merger do? Uniting ITV would transform its currently dysfunctional structure in which two companies struggle for control of the central network. Some £55m a year of costs could be saved. Everything depends, however, on what the competition authority decides to do about advertising. Carlton and Granada fear it will force them to sell off their advertising sales houses, which could wipe out up to a third of cost savings. Under those circumstances Mr Green might call the merger off.

Merger or no merger, institutional shareholders in Carlton and Granada want rid of Mr Allen and Mr Green, mainly because of the ITV Digital fiasco. Mr Allen is more vulnerable than Mr Green, says a London media banker, because the latter at least built Carlton himself from nothing, while the former was a hired hand who was given a great company and mismanaged it. Investors will probably wait for a merger to go through and then take action.

One willing candidate for the job of boss at a merged ITV would be David Elstein, former head of Channel 5. Mr Elstein argues that a merged Granada and Carlton could save far more than the £55m touted by the two companies' current management. His most radical idea is that they should make less programming themselves and buy more from outside. Four-fifths of ITV's entire programming budget, according to Nick Bell, an analyst at Bear Stearns, is spent on original commissioned programming (rather than American shows, or repeats) and of that over half comes from Granada. The result, Mr Elstein argues, is that ITV is run not to win the maximum number of viewers and therefore advertising

revenues, but to stuff lots of Granada and Carlton programming onto the schedule.

What a merger will not do for Carlton and Granada is lift the complex regulatory framework that governs ITV. Earlier this year Mr Dyke suggested that it might be tempted to go entirely digital—then it would not have to pay an analogue licence fee or provide public service broadcasting, which often turns viewers and advertisers off. People at Carlton, certainly, have run the numbers on going digital. An ITV with its sales houses intact, unhampered by a public service broadcast requirement, would be particularly attractive to a foreign buyer. Disney, Saban Capital Group, Viacom and no doubt others as yet unknown are interested in buying ITV. Next week's decision will be watched eagerly from New York and Los Angeles.

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**Bouncers**

# Jobs for the boys

Oct 2nd 2003
From The Economist print edition

### Cleaning up a tough profession

PITY the poor bouncers. Not only must they cope with what Tony Smith, manager of Right Guard Security, calls “the shitty side of life”—drink- and drug-addled customers going at each other with broken bottles, and worse. They must also do so nicely. Beginning next month, bouncers will be asked to take part in four-day training programmes that cover such improbable topics as conflict management. Within two years, such training, along with rigorous background checks, will be mandatory in England and Wales. A profession that has long provided jobs for toughs will itself become harder.

This is all part of a drive to impose order on the burgeoning night-time economy. Since the early 1990s, magistrates and local authorities have permitted large numbers of licensed premises to open in city centres, many of them until the early morning. The hope was that Britain would develop a Barcelona-style café culture. That didn't happen—indeed, it didn't even get New York-style bar culture. Instead there was an explosion of large drinking dens.

Cardiff's pubs and clubs, for example, can legally accommodate 68,000 revellers, compared to 38,000 four years ago. Since the police reckon to assign no more than twenty officers to public order duty on a given Saturday night, the need for burly men (and a few women) is obvious. Not surprisingly, they often get caught up in trouble. A recent study found that doormen were involved in 16% of all alcohol-related violent incidents in the city centre; in the 30 months to December 2001, 61 were arrested.

The violence dished out by bouncers may be shocking, but it is well suited to the post-midnight environment of Britain's provincial towns. When properly used, force is a quick, efficient way of dealing with problems inside clubs. Dick Hobbs, a Durham University sociologist, says: “It's a very specific form of social control—one that suits the commercial needs of licensees. And the state simply can't provide it.”

It would be good if bouncers knew how to eject troublemakers without landing them in hospital, of course. The new training courses will not teach them how to do so. This puzzles bouncers, as it does instructors who teach one- and two-day courses for the smattering of local authorities that currently require them. Jason Dyson, who runs Achilles Security, in London, has been teaching arm locks for years. “Better we teach them than they make it up on the night,” he observes.

Bouncers' other complaint about the new regime is that it will be costly. The training courses will be twice as time-consuming, and twice as expensive, as anything currently required—quite a burden for the many part-timers. Since the Security Industry Authority (SIA) reckons to fail 30% of applicants, many will have to come back for more.

They shouldn't complain. By raising entrance costs, and barring men with criminal convictions, the new regulations will turn bouncers into a scarce resource. Assuming, rather optimistically, that bouncers are only as criminal as other citizens, the new background checks will force 12-14% into immediate retirement. That will raise pay—by £4 an hour, according to the SIA. And since licensing schemes will go national just as pubs begin to take advantage of deregulated opening hours, roughnecks are likely to find themselves in great demand.

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Bagehot

# Labour's love-in

Oct 2nd 2003
From The Economist print edition

### Why the party wasn't beastly to its leader

Get article background

IT WAS billed as the most difficult and important speech that Tony Blair had ever had to make (although there have been a few of those recently). Mr Blair was in trouble with his party as never before: over the decision to go to war alongside the hated President Bush; over the failure to find any weapons of mass destruction; over the Hutton Inquiry and the widespread belief that the case for war had been deliberately exaggerated; over foundation hospitals and university top-up fees.

Surely the Labour Party had finally had enough of a leader it had never loved? Surely the distance between Mr Blair and his party that had always been there was now an unbridgeable chasm? And there to prove it, the day before, had been Gordon Brown, electrifying the conference with a tub-thumping paean to traditional Labour values and winning a two-minute standing ovation. The best that Mr Blair could expect from the same audience was icy politeness. Mr Blair had had his day; the torch would soon pass.

If that was the script, either the conference hadn't read it or, more likely, it had and had decided that it didn't like it. Sometimes, speeches are remarkable for what they say. Sometimes it is the performance that stays in the memory. On both counts, Mr Blair scored well. He had decided to conduct an intelligent, mature discussion with his party about the trials and responsibilities of office. Deliberately short on rhetoric, it was nonetheless cleverly done.

But what was extraordinary was the audience. First came the two-minute standing ovation before Mr Blair had even reached the stage. Then there were the explosions of clapping and even cheering at every pause in his speech. Even when the prime minister was pushing on some distinctly cold buttons—explaining his reasons for going to war or why the NHS had to change—the applause continued. And at the end, there was another standing ovation—this time lasting seven minutes—and chants of “We want Tony” after he had left the hall.

In more than 30 years of attending Labour Party conferences, Bagehot had seen nothing like it before. Yet the very next day, the conference slapped its leader in the face by voting against the government's policy on foundation (semi-independent) hospitals. The prime minister's relationship with his party has never been straightforward, but how to explain what has been going on in Bournemouth this week?

The first thing that rapidly became apparent is that there is astonishingly little desire to punish Mr Blair for Iraq. If Mr Blair wants to lend President Bush a hand in any new military adventures without UN approval, there will be a parting of the ways. But for now, on all sides, there is a desire to move on. After weeks of the Hutton Inquiry, a sort of exhaustion has set in. It's not exactly forgive and forget, more that what's done is done.

Significantly, at the hundreds of fringe meetings, Iraq has figured relatively little. Clare Short, the secretary of state for overseas development who resigned over the war and has continued bitterly to attack the prime minister, has cut an unexpectedly lonely figure in Bournemouth. The demonstration of support for Mr Blair during his speech was intended, as much as anything, as a signal to the media to lay off.

## The feelgood factor

Something else which has been noticeable has been a quiet pride in what the activists see as the government's domestic achievements. For any committed Labour supporter under the age of 60, this is quite simply the best government they have ever lived under. Not only has it now lasted longer in office than any of its predecessors, but it can also reasonably expect to stay in power for as long again. Previous Labour governments presided over short bursts of public spending, followed by longer periods of retrenchment forced on them by their own economic incompetence. But this government believes, in Mr Brown's words, that it can now “lock in” the much higher levels of spending on health and education of the last few years.

There is also a growing feeling in the party that the government is not getting the credit it deserves. This is partly because public-sector workers have yet to break the habit of moaning even when everything around them, including their own pay, is improving. It's partly the fault of London-based journalists (London has problems all of its own with public services) who relentlessly maintain that the money the government is spending is all being wasted. And it is partly the government's own fault for being embarrassed to admit just how aggressively redistributionist it really is.

This is now a confident party—confident in its ability to win elections, confident that thanks to its record in government Labour has now conclusively won the case for tax and spend, and confident that Mr Brown's “Labour values” are shared by a majority of Britons. When Mr Blair tells his party that the 21st century will be as much a victory for progressive politics as the 20th was for the politics of conservatism, it doesn't just want to believe him: it does.

This confidence has been a help to Mr Blair this week. But such self-satisfaction, bordering on complacency, is also dangerous to him. Mr Blair's constant refrain about the need for further public-sector reform increasingly grates. “Reform” equals criticism, which plays into the hands of the Tories. As even Mr Brown finds it difficult to keep the public spending gusher flowing, the demands from the party for tax increases aimed at the relatively affluent will become more strident. What might have been regarded as electoral suicide a few years ago is now thought of as positively populist. In short, this is a party that thinks it has won the argument and is now bored with the stealthy egalitarianism that has served New Labour so well.

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**Terrorism and business**

# Peril on the sea

Oct 2nd 2003
From The Economist print edition

**Are terrorists now aiming to block shipping lanes and disrupt the flow of oil and other goods ?**

ON MARCH 26th, the *Dewi Madrim,* a chemical tanker off the coast of Sumatra, was boarded by ten pirates from a speedboat. They were armed with machine guns and machetes and carried VHF radios. They disabled the ship's radio, took the helm and steered the vessel, altering speed, for about an hour. Then they left, with some cash and the captain and first officer, who are still missing.

So what? South-East Asia is the home of piracy. There was an alarming 37% increase in incidents during the first half of this year. Raiders board ships, steal cash and kidnap crew members, then hold them for ransom. Some criminals even steal a ship and sell its cargo—then repaint it, equip it with false documents and put it to work. The region, with its lax security and poor maritime supervision, is famous for such “ghost ships”.

But according to a new study* by Aegis Defence Services, a London defence and security consultancy, these attacks represent something altogether more sinister. The temporary hijacking of the *Dewi Madrim* was by terrorists learning to drive a ship, and the kidnapping (without any attempt to ransom the officers) was aimed at acquiring expertise to help the terrorists mount a maritime attack. In other words, attacks like that on the *Dewi Madrim* are the equivalent of the al-Qaeda hijackers who perpetrated the September 11th attacks going to flying school in Florida.

Coupled with this, there is evidence that terrorists are learning about diving, with a view to attacking ships from below. The Abu Sayyaf group in the Philippines kidnapped a maintenance engineer in a Sabah holiday resort in 2000. On his release in June this year, the engineer said his kidnappers knew he was a diving instructor; they wanted instruction. The owner of a diving school near Kuala Lumpur has recently reported a number of ethnic Malays wanting to learn about diving, but being strangely uninterested in learning about decompression.

Aegis's intelligence has turned up links between big criminal gangs in the area and terrorists, driven by the need for the latter to finance their operations. There have been ten cases of pirates stealing tugs for no apparent reason; the worry is that they are for use to tow a hijacked tanker into a busy international port, such as Singapore.

On September 16th 2001, America closed the port of Boston, fearing that terrorists would attack the gas terminal in the port. To this day, gas tankers bound for Boston have to be escorted by coastguards from 200 miles away from the port.

An incident on October 18th 2001 increased anxieties about terrorists using shipping, especially container ships, to smuggle people and explosives around the world. Authorities in the southern Italian port of Gioia Tauro found a stowaway in a well-appointed container, fitted out with a bed, toilet, heater and water. He also had a laptop computer, mobile and satellite phones, and airport security passes and a mechanic's certificate for JFK, Newark, Los Angeles International and Chicago O'Hare airports. Fears grew further after a torpedo attack by terrorists on a French tanker, the *MV Limburg*, in Yemen in October 2002.

The likeliest terrorist target is a tanker carrying liquefied petroleum gas (easier to explode than natural gas), reckons Aegis's Tim Spicer, formerly a British soldier and head of Sandline, a “private military company” (a euphemism for a supplier of mercenaries) that achieved notoriety for its work for the British government in Sierra Leone. He fears that hijacked gas and oil tankers could be used to block the Malacca Strait, or the Panama or Suez Canals. That could wreak economic havoc. The UN estimates that ships carry 80% of the world's traded cargo—5.8 billion tonnes in 2001.

## Not shipshape

An OECD report† on maritime security, published this summer, points out that the shipping industry is having to invest $1.3 billion this year on improved security and will face running costs of $730m a year to maintain better security systems. There are 46,000 merchant ships and 4,000 ports around the world and, as Aegis points out, it will take some considerable time to bring them up to scratch.

Other reforms are also proceeding too slowly. On October 1st, America's Bureau of Customs and Border Protection was supposed to introduce new rules requiring shipping lines to advise the agency by computer or by fax about the contents of incoming cargo vessels. It now says it has delayed publishing its requirements until later this month—although it is not entirely clear why. The idea behind the new rules is to improve the quality of screening—but the sheer volume makes comprehensive screening impossible. With 232m container movements through the world's ports each year, it is now practical to look inside only about 2% of them.

America, at least, has made more progress in requiring foreign ports to allow American officials to check cargo before it sets sail for America. The world's biggest ports quickly co-operated, because they feared that, if they did not, they might have been frozen out of trade with America.

Then there is the thorny problem of screening crew members. Half of the world's merchant fleet, with 1.2m seafarers on board, sails under a flag of convenience. Paperwork and background checks are often minimal. After the September 11th attacks, the International Labour Organisation introduced identity cards for seafarers—but nobody has much faith that this has solved the problem.

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*“Aegis Terrorism Report 2003”: www.aegisdef.com. †“Security in Maritime Transport: Risk Factors and Economic Impact”, OECD, July 2003.

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America's corporate scandals

# Their day in court

Oct 2nd 2003 | NEW YORK
From The Economist print edition

**The celebrity ex-bosses will put up a good fight in court**

AFTER the humiliating “perp walks” and charges of corruption and fraud, it may be surprising that America's celebrity ex-bosses have much fight left in them. But as Dennis Kozlowski, Tyco's ex-boss, and Frank Quattrone, a former star banker, arrived at separate New York courts this week to begin their trials, it became clear that, for all their tribulations, they are not about to accept their fate meekly.

Outside court, Mr Kozlowski chatted with reporters about his daughter's wedding at the weekend. Mr Quattrone strode confidently into court with John Keker, his defence lawyer, who drew attention not just to the charges—that Mr Quattrone had obstructed a federal investigation into the IPO share-allocation practices of his former employer, CSFB—but to why prosecutors might have brought them. “You're sitting in judgment of a man, not a symbol,” said Mr Keker, as he warned the jury that it would probably be hearing about Mr Quattrone's famously lavish pay.

AP

**Kozlowski enjoys being a celebrity again**

Other legal talents will soon echo Mr Keker's theme. The Koslowski and Quattrone trials mark the start of a clutch of white-collar cases featuring former business stars from the late 1990s. Defence lawyers in most of these will claim that overzealous prosecutors, under pressure to slake the public's thirst for blood, picked on their clients as expedient symbols of greed and excess—but their clients did not commit any crime. In April, John Rigas, the former boss of Adelphia, a bust cable-TV firm, made an emotional plea in the *New York Times*, claiming that the charges of looting filed against him and his two sons were a “misrepresentation, a big PR effort”. Facing charges that she obstructed an insider-trading investigation and defrauded her own shareholders, Martha Stewart, ex-boss of the eponymous home-furnishings empire, has also fought back. “Why has the government, after nearly a year and a half, chosen to file these charges?” asked Robert Morvillo, her defence lawyer, in June. “Is it for publicity purposes because Martha Stewart is a celebrity?”

Of all the ex-bosses, she may have the best shot with this defence. The securities-fraud charge is a legal innovation. The government's apparent intention to force Ms Stewart's own lawyers, Wachtell, Lipton, Rosen & Katz, to testify against her is raising eyebrows. Should her case go to trial, the jury may find these tactics aggressive and unfair. The risk for the prosecution, says Daniel Horwitz of Carter, Ledyard & Milburn, a law firm, is that the jury will throw out the obstruction-of-justice charges along with everything else.

Then there is the evidence. Mr Quattrone's case involves a series of e-mails. One, from a colleague, forwarded by Mr Quattrone only two days after he heard about possible subpoenas from federal investigators, urges staff to “clean up those files”. Mr Keker claimed this week that the forwarded e-mail only addressed, in a general way, the wisdom of enforcing the bank's document-retention policy. The prosecution will rely on testimony from David Brodsky, the bank's former general counsel, that he had only just made Mr Quattrone aware of the feds' interest.

The trial of Mr Kozlowski, who is accused of looting Tyco of hundreds of millions of dollars, will last up to four months, the judge told astonished jurors this week. Stephen Kaufman, Mr Kozlowski's lawyer, will point out that his client did not hide anything, that the firm's auditor at PriceWaterhouseCoopers was informed about all the disputed transactions (many of which involved using an executive-loan scheme to

buy property), and that the auditor talked regularly with the board.

Prosecutors will emphasise that the board did not explicitly authorise many of the transactions, that Mr Kozlowski had bought board loyalty and that the auditor has since been barred for life. Prosecutors will also hope that the sheer volume of evidence eventually weighs on the jury. The indictment of Mr Kozlowski and his chief financial officer, Mark Swartz, lists 15 separate charges of grand larceny and 67 charges of falsifying business records.

The trial of Mr Rigas, scheduled for January, is likely to involve a similar exploration of what the board, auditor and outside counsel knew of and approved, and the intent of Mr Rigas when he authorised borrowings by private family companies partly secured (and undisclosed to shareholders) by Adelphia's assets.

Do the ex-bosses have a point? It is true that prosecuting corporate fraud became a top political priority last year. It is also true that what has really animated the public—obscene executive pay—seems mostly to have been a social pathology, not a crime. And with the emphasis they place on a few “rotten apples”, celebrity trials could detract from the broader task of reforming governance and regulation. But the charges mostly look well-investigated. No criminal charges, meanwhile, have yet been brought against the former chief executives of HealthSouth or Enron, two of the biggest scandal-hit firms, although Enron's former finance chief, Andrew Fastow, is due to stand trial next year.

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Electricity

# Like a candle in the wind

Oct 2nd 2003
From The Economist print edition

**Why do the lights keep going out?**

SUDDENLY it is a trend. Or so it seems to millions of people in developed countries who have been plunged into darkness these past two months by power cuts. On August 14th, the lights across much of eastern North America went out. Two weeks later, London suffered a brief but annoying power cut during rush hour. Then parts of Scandinavia lost power. Then, on September 28th, most of Italy lost power in the middle of the night.

AP

**Let there be light**

Power cuts are routine in the developing world. But in the rich world massive blackouts seemed to be a thing of the past. True, small power cuts have always been a fact of life, especially outside big cities. English villages often lose power during winter storms. The Electric Power Research Institute calculates that, on average, every day perhaps half a million Americans lose power for over two hours—costing the American economy $100 billion a year. But the scale of the recent power cuts was exceptional.

Why did most of those earlier power-cuts stay localised while the recent ones got so big? The short answer is that nobody quite knows yet.

Conspiracy theorists point a finger at terrorists or teenage hackers. But no evidence of this has turned up (yet). The authorities blame unexpected storms, tree branches falling on high-voltage power lines (as in the Italian example) and other acts of nature. Another factor may have been safety equipment that was installed improperly (as in Britain). Preliminary investigations suggest some degree of human error or inaction may have made natural accidents worse in some recent cases (above all, in America) turning local problems into bigger ones. David Victor, head of Stanford University's energy programme, says that the likeliest explanation is bad luck: “Four times in a row is not impossible—especially when key markets have neglected their transmission and generation systems and thus loaded the dice for disaster.”

That points to the likeliest explanation: the halting, half-hearted approach to electricity deregulation in America and Europe. The rich world's electric networks are currently midstream between an old command-and-control world and a brave new liberalised world of market signals and competition. This may have made them more vulnerable to big power-cuts.

That is not because deregulation inherently carries the risk of more blackouts—a trade-off, some say, necessary to get cheaper power. That is a false choice. On the contrary, open borders and competitive markets are a far better guarantor of energy security than the Stalinist model of yesteryear. Mr Victor points out that India's electricity system is about as vertically integrated as you can get, yet it is also widely regarded as the most corrupt, inefficient and blackout-prone in the world.

The risk is greatest in countries that have implemented half-baked reforms. America's flawed deregulation has left its grid suffering from serious under-investment, which contributed to the recent blackout: transmission lines were old and overloaded, grid computers failed at critical moments, and so on. Britain, by contrast, has invested plenty in transmission; that is why it was able to contain its blackout and to restore power in less than an hour, while America's outage “cascaded” through many

states and lasted overnight. In Italy, too, partial reform was a likely culprit. The European Commission insisted this week that Italy's reluctance to expand cross-border trading and to build new international transmission lines was partly to blame for the latest blackout.

The awkward fact is that it is virtually impossible to store power efficiently. As a result, demand must match supply absolutely perfectly at every given moment—or else the lights may go out. Therefore some sort of system operator or grid manager will always be necessary. It is folly to think that deregulation will ever mean no regulation at all in this market. The blackouts in America and Europe are best seen as teething pains for systems in transition, argues Jo Whitehead of the Boston Consulting Group, as regulators pragmatically work out what precisely their role should be in liberalised markets.

Claude Mandil of the International Energy Agency, a quasi-governmental group founded by OECD countries as a counterweight to the OPEC oil cartel, observes that the strategic petroleum stocks that his group manages help form a buffer for the world oil market. Since electricity cannot be stored in the same way as oil, no such centralised buffer is possible. That is why regulators in each country must ensure that there is enough spare generating capacity—boffins say perhaps 20% above expected peak load—and transmission capacity to be sure the lights stay on.

How best to do this? That is one of the questions sure to confront the many hundreds of regulators about to arrive in Rome (ironically enough) for the World Forum on Energy Regulation. Back in the days of state-run monopolies, power companies used to “gold plate” their assets at the expense of hapless ratepayers. In today's liberalising markets, regulators have yet to figure out the best way to achieve that reserve margin without damaging the new incentives they are trying to introduce.

They face a tricky task. Mr Mandil points to one reason: “It is expensive to maintain reserve margins in production and transmission capacity... Ultimately, it is the consumer who must pay the cost.”

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German business

# Salvation?

Oct 2nd 2003 | FRANKFURT
From The Economist print edition

**A plan to save a fallen German angel**

CORPORATE change is under way at last in Germany. What has started to break the jam that clogged restructuring in Germany for decades? The answer is not entirely clear. It could be better tax treatment for spin-offs since 2002, or a new wave of management theory being applied. Perhaps it is a generational thing, as family businesses run out of capable or willing heirs. Or perhaps firms exhausted by the harsh economy have simply found that they must restructure to survive.

Consider MG Technologies, a processing-plant manufacturing and chemicals conglomerate, which this week said that it would split itself in two, hoping to sell the most valuable half, specialist chemicals division Dynamit Nobel, for “well over” €2 billion ($2.3 billion). Under its old name, Metallgesellschaft, the firm achieved notoriety in 1993 when an American subsidiary lost $1.3 billion in bets on oil-futures contracts and nearly bankrupted the parent. A new boss, Kajo Neukirchen, transformed the firm, but took on too much debt and fell out with its new biggest shareholder, Otto Happel. He finally forced out Mr Neukirchen in May.

This week, Udo Stark, MG's chief executive of four months, tried to paint the break-up plan as a masterpiece of corporate vision worthy of a Harvard Business School graduate who already has a successful restructuring under his belt—of Agiv, another conglomerate. The retained half of the firm, he said, would offer a new corporate model for Germany's reformed middle-sized businesses, a cluster of *Mittelstand* companies held together by strong financial controls from the centre.

The reality is quite different. On August 21st Moody's, a rating agency, put MG‘s debt on watch for a potential downgrade to junk. MG has an outstanding Eurobond whose coupon would rise in the event of a downgrade. Small wonder that the firm needed a new plan. Early next week, Mr Stark will call on Moody's analysts in the hope of convincing them that his new strategy deserves a better verdict.

MG is by no means alone in Germany in having to restructure for financial rather than strategic reasons. Germany's once accommodating banks have started to get tough, because regulators are forcing them to give each borrower a risk-sensitive rating. Still, if this is what it takes to force corporate Germany to make the changes which it has put off for so long, so be it.

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**Spending on information technology**

# Some like it cold

Oct 2nd 2003 | SAN FRANCISCO
From The Economist print edition

**Information-technology spending is not so much recovering as changing**

TECHNOLOGY vendors, investors and analysts have been poring over data with a magnifying glass lately to find signs of a recovery. But the data are inconclusive. One index of expected tech spending by American firms pointed up in June, less up in July, and even less up in August. Tech firms are also sending mixed signals. Dell and HP, two hardware makers, made optimistic noises in August, but Oracle, the world's second-largest software firm, said in September that its sales of new software were down by 7% in the latest quarter. On September 29th, shares in Sun Microsystems, another hardware maker, plunged when it said that its losses for the past three months would be more than expected.

The big picture does suggest that American companies are now planning to spend a bit more again. Andrew Bartels, an analyst at Giga Research, an IT consultancy, estimates that tech spending will rise by about 2% this year and that investment in new technology (excluding salaries for IT staff and fees to consultants) should grow by around 6% annually for the next four years (see chart).

Admittedly, that is underwhelming—not only by the standards of the bubble in the late 1990s, when tech spending grew by an average of 11% a year, but also by comparison with the late 1970s and early 1980s, when growth averaged 16%. One reason for the current doldrums is that many firms still regret binge-buying during the bubble. Another is the lacklustre economy. A third, more fundamental, reason is the long-term technology cycle.

Steven Milunovich, an analyst at Merrill Lynch, thinks that the tech industry evolves through waves lasting 10-15 years, as innovation leads to a burst of spending on new technologies, then to a less exciting period of assimilation. In the 1970s and early 1980s, for instance, firms stocked up on the new thing at the time, mainframe computers. IT spending soared from less than 2% of GDP to about 3%. It then stayed at that level for almost a decade, as firms worked out how to get the most out of their machines. In the 1990s, they started investing again, this time in the new technology of client-server systems. By 2000, tech spending was almost 5% of GDP.

Since then, it has fallen back to about 4% of GDP as IT managers have repented of their bubble sins. Their penance is now pretty much done. Even so, reckons Mr Milunovich, firms have now entered a phase of assimilation, with the emphasis on making tangible returns on their technology investments, past and present. As a result, he says, IT spending is likely to grow only as fast as GDP for a few years.

Pip Coburn, an analyst at UBS, calls this environment “cold tech”—in contrast to the bubble era, when tech was “hot”. Firms now spend on different things, such as software to make their expensive bubble-era systems work together. Antivirus software and firewalls are other big items. Some companies are moving their IT functions to cheaper places such as India.

The hottest “cold” technology is Linux, an operating system that comes free, except for maintenance costs. In March, Forrester, an IT consultancy, found that 72% of corporate IT managers were intending to move their server-computers to Linux from Microsoft and Unix software.

This trend briefly seemed to be in jeopardy, after SCO, a firm that owns the copyrights to Unix, claimed

that Linux contains bits of Unix that violate SCO's intellectual property. This summer, SCO started threatening to sue Linux users. To experts, this looked like a ploy by a failing company to extort money. Nonetheless, according to Forrester, it intimidated some 16% of firms into slowing their adoption of Linux.

They probably became less shy on September 24th, when HP, which makes about $2 billion in sales from products that use Linux, said it would indemnify customers against any lawsuits brought by SCO. Other vendors are likely to follow, unless SCO gives up first. With tech this cold, Linux is too hot not to handle.

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American telemarketing

# Powell's call

Oct 2nd 2003 | NEW YORK
From The Economist print edition

**The chairman of the FCC gets a chance to redeem himself**

OPPORTUNITY knocks for Michael Powell, the vilified chairman of America's Federal Communications Commission (FCC). Accused of everything from wrecking telecoms regulation to climbing into bed with giant media conglomerates and destroying democracy, Mr Powell now has a chance to do something that Americans really want: stop annoying telemarketing calls.

Since 1990, Congress has urged both the FCC and the Federal Trade Commission (FTC) to clamp down on intrusive telemarketing practices. After a turf war, the FTC eventually said that it would create a national “do-not-call” list. Telemarketers who phoned people on this list would be fined. Shaking hands and making up, the FCC and the FTC agreed jointly to enforce the list. Using a website and a toll-free number, 50m Americans had signed up even before the list was due to take effect on October 1st.

Meanwhile, telemarketers and their lobby groups launched several speculative legal challenges. On September 24th, a federal judge in Oklahoma City ruled that Congress had failed specifically to authorise the FTC to create the list, and that the agency had exceeded its authority. The next day Congress swiftly passed an act giving the FTC the authority. But a second federal court, in Denver, then ruled that the list violated the First Amendment (which protects free speech) because it discriminated between telemarketers on the one hand and, on the other, political fund-raising groups and charities, both of which had won exemptions from the new rules. This time there was no fast response from Congress, as members balked at voting to hamper party funding by banning political fund-raising calls.

Then Mr Powell stepped in, pointing out that the Denver ruling applied only to the FTC, and that, pending yet another court case, the FCC could meanwhile enforce the FTC's list. Anticipating lots of complaints, the system had been highly automated. But because the Denver judge prohibited the FTC from giving its list to the FCC, enforcement may now rely on a somewhat ad hoc collection of manual processes. Much may depend on the attitude of telemarketers. In the confusion, they themselves have revealed splits, with one lobby group urging its members to follow the new rules and a second sounding more agnostic. The courts could take several more months, or longer, to resolve the issue. In the meantime, expect Mr Powell to throw all the resources he has at the task.

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Mobile gaming

# Gaming's new frontier

Oct 2nd 2003
From The Economist print edition

**Mobile phones are bringing video games to a broader audience**

“BIGGER than Hollywood”—that is how people in the video-game industry like to describe their business. Worldwide sales of games software, they note, were worth $21 billion last year. Global box-office takings were a mere $19 billion (though Hollywood also gains from DVD and video sales and rentals).

Yet gaming is still not truly mainstream. Gamers are mostly young and male, and they must have sufficient disposal income to buy a console, costing around $200, and games, around $50 each. That may soon change, thanks to technology's new Trojan horse, the mobile phone.

Around 450m mobile phones are sold every year, and most people upgrade their handsets every couple of years. The latest have colour screens, internet access and powerful processing chips. As well as logos and ringtones, it is now possible to download on to them small pieces of software—such as games.

According to the Mobinet study of 5,600 mobile users in 15 countries by A.T. Kearney, a consultancy, and the Judge Institute of Management at Cambridge University, the number of people playing games on their handsets has doubled during the past year to 6% of the world's 1.3 billion mobile subscribers, and will soon outstrip the number of people gaming on consoles. As if to underline the growing interest in mobile play, Nokia, the world's leading handset-maker, will next week launch the N-Gage, a hybrid mobile phone and gaming handset. Has the games industry finally found a way into the hearts, and pockets, of a broader audience?

## Playing to win

That certainly seems to be the case in South Korea and Japan, the world's most developed mobile markets, where handsets that support downloadable games have been available for two or three years. The proportion of users who play games on their handsets has risen to 15% in South Korea and 35% in Japan, spreading gaming beyond its traditional user base.

New gamers want something different from existing players. They want not an immersive experience, but a time filler, akin to doing a crossword, says Ben Wood of Gartner, a consultancy. Classic arcade games, such as Pac-Man and Space Invaders, are particularly well suited to mobile play. But Asian trends suggest that while such “retro-gaming” classics appeal to early adopters, the balance shifts towards simpler games, such as card games, as women and the middle-aged start to play.

The usual model is that users pay once to download a game, costing around $3. Some games are subscription based, and multi-player games, which are starting to appear, also involve extra charges. The market, worth $587m this year, is forecast to reach $3.8 billion by 2007, according to Informa Media Group; within four years 500m people—25% of mobile subscribers—will play on their phones.

Where does Nokia's new N-Gage fit in? With more processing power than other phones, it can run 3-D games such as “Tomb Raider”, first designed for Sony's PlayStation console. Indeed, the N-Gage is not so much a phone optimised for games as a gaming device that happens to have a phone in it. Yet rather than aiming at the new, broader audience of mobile gamers, it is for “hardcore” users who want to play complex games on the move; a direct challenge to Nintendo's Game Boy Advance, the top handheld games console.

Moving into an entirely new market in this way is risky, even for a giant such as Nokia. Worse still, Sony,

which dominates the household-console market, has announced plans to launch its own handheld console, the PlayStation Portable, in 2004. But Ilkka Raiskinen, who runs the N-Gage project, insists that Nokia has a unique advantage: its understanding of mobile communications. N-Gage users will be able to take part in multi-player games—with people in the same room via a short-range radio connection and with other mobile users via the cellular network. “Mobile and online gaming are the key trends in the industry,” says Mr Raiskinen. The N-Gage is aimed at the intersection of the two. The Nintendo and Sony consoles, in contrast, will only allow wireless gaming with players in the same room.

But Nokia is in for a fight. The N-Gage costs twice as much as the Game Boy Advance and has far fewer software titles, notes Nick Gibson of Games Investor Consulting. Consumers may not regard the phone and multi-player capabilities as worth the higher price. Nokia must subsidise game development for a year or two, as games are not profitable until there is a large installed base of users. Finally, says Mr Gibson, Nintendo will fight hard to keep its lead in the handheld-console market, since it is in third place, behind Sony and Microsoft, in household consoles.

Nokia is simply getting into new markets while it can, reckons Mr Wood. Motorola, the number two handset-maker, is flailing, and Samsung, the number three, is growing fast but is still behind. “Nokia has a window of opportunity to take some gambles, and try to open up some new segments,” says Mr Wood. It is strong in high-volume electronic devices. As well as the N-Gage, it has also launched a hybrid music-player handset. Last month it even unveiled a range of jewellery, to which users can beam images from their camera-phones. Of these various bets, says Mr Wood, Nokia only needs one to succeed.

Nokia's move into the handheld gaming market, from an adjacent market which it dominates, is strongly reminiscent of Microsoft's decision to launch the Xbox console to challenge Sony. Like Microsoft, it is about to discover that the gaming market is deadly serious.

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Face value

# Barbarian at the gates?

Oct 2nd 2003
From The Economist print edition

**Haim Saban is the new bogeyman of Europe's media industry**

ASK a British television executive about Haim Saban and his face will typically assume an expression of disdain, mixed with fear. Mr Saban, an American-Israeli Jew born in Egypt, bought ProSiebenSat.1, Germany's largest privately-owned television network, this summer. No foreigner has ever before owned such an important media outlet in Germany. Now Mr Saban is eyeing up ITV, Britain's biggest commercial-TV network. Next week the government is due to say whether it will allow ITV's two main firms, Carlton and Granada, to merge. If, as expected, the merger is given the green light, Mr Saban may join a list of foreign bidders eager to gobble up both firms.

He has already created headaches for himself, however. At a broadcasting-industry conference last month in Cambridge, he not only expressed interest in acquiring ITV, but then went on to accuse the BBC and Sky News, a British satellite-channel owned by Rupert Murdoch, of putting out biased, overly pro-Arab coverage of the Middle East. Alarm bells rang. British media law requires that TV news be impartial and not influenced by the political beliefs of a proprietor. When pressed, Mr Saban said that, if he were the owner of ITV, he would not interfere with how journalists cover the news. But it was too late. His audience was left with the impression that this was “a man motivated by editorial concerns, not a businessman,” as one broadcasting executive put it. Officials at Ofcom, Britain's new media regulator, were amazed by what one called his “pig-ignorant” behaviour. They would have the power to stop him buying ITV.

People who have dealt with Mr Saban in America dispute the suggestion that he is not a businessman to the core. He does deals, says one investment banker who knows him, like a Middle Eastern market trader and, by western standards, is “as hard as nails.” That has enabled him to become a billionaire from humble beginnings. Born in Alexandria, his family moved to Israel during the 1956 Suez crisis and were so poor that at one point they had to share a communal bathroom with prostitutes.

Mr Saban's big break came after he had set up a successful business in France that sold the rights to theme tunes for TV shows. In 1992, he managed to sell an obscure Japanese TV programme to Fox Kids Network, then a new cable channel owned by Mr Murdoch's News Corp. With American touches, it developed into the “Mighty Morphin Power Rangers”, a violent children's show which became a huge hit. Mr Murdoch and Mr Saban built Fox Family Worldwide in America on the back of the show, and in 2001 persuaded Disney to pay $5.2 billion for it. Mr Saban received about $1.5 billion. Wealth has allowed him to loom large in the world of politics—he gives millions to the Democratic Party in America and founded a Middle East think-tank at the Brookings Institution in Washington, DC, directed by Martin Indyk, a former American ambassador to Israel.

Should Europeans worry about a foreigner with deeply-held political beliefs owning TV companies whose broadcasts go into the homes of millions? British media folk especially fear that an American buyer of ITV might create a version of Fox News, the popular conservative, flag-waving American channel started by Mr Murdoch. A few countries are scrapping the laws which in the past have kept foreigners out; for those who want to keep the barriers up, Mr Saban is the perfect bogeyman. But the likes of Mr Saban and Mr Murdoch are less scary than they appear.

Letting a few foreign voices into national media markets which have already become diverse and cacophonous will not result in the brainwashing of the public. Indeed, because they are foreign, their

activities are sure to be carefully monitored, and their prejudices well-known. The real danger is not opinionated foreign owners, but the concentration of media outlets in the hands of a few, whether foreign or native. Worst of all are local media owners who are too close to government. By this measure, the domestic newspaper and television empire of Silvio Berlusconi, Italy's prime minister, represents much the most potent threat to democratic values.

## Let the foreigners in

As much as British TV executives dislike the idea of being invaded by aggressive Americans, they can take comfort from the strong regulatory system overseeing TV in Britain, as in much of Europe. (Viewers who might like a more opinionated alternative to traditional “balanced” British news coverage may take less comfort.) Mr Saban—or Mel Karmazin, chief operating officer of Viacom, another of ITV's suitors—would risk getting kicked out if they tried to influence news coverage, or if they cut back on the educational programming required by the public-service obligations imposed on most European broadcasters. With such regulation of content already in place, the banning of foreigners seems a blunt and anachronistic tool.

America has limited foreign media ownership since 1912, supposedly to protect military communication. But that rationale is now irrelevant, argues Gregory Sidak of the American Enterprise Institute, and only serves to limit the capital available to the industry and deprive Americans from receiving as many foreign shows as they might wish. Italy, France and Spain, among other countries, ban foreigners too.

In Germany, Mr Saban has been welcomed, albeit for being neither Mr Berlusconi nor Mr Murdoch. So far he has said little about his plans for ProSiebenSat.1. He may simply wait for advertising to recover and then sell the channel at a profit. Going after ITV would be an undertaking on a different scale—Mr Saban and six private equity firms have so far paid €525m ($600m) for control of ProSiebenSat.1. Granada and Carlton are worth nearly $6.5 billion. “There is no hope in hell that Saban will buy ITV,” says a media executive. But that may be wishful thinking. Mr Saban clearly knows how to make, and to raise, money.

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Airlines

# Open skies and flights of fancy

Oct 2nd 2003
From The Economist print edition

Alamy

**Europe and America began talks this week on liberalising flights across the Atlantic. They could lead to a long overdue rationalisation of the airline industry**

Get article background

THE airline business is an aberration. Distorted by decades of subsidies and international cartels, it has never earned a real rate of return on its investors' capital in its 60 years of existence. Two developments this week give hope that that may be about to change. Negotiators from the European Union and the United States held their first talks in Washington, DC, about liberalising transatlantic aviation, the day after an announcement that Air France and KLM Royal Dutch Airlines are to come as close to a cross-border merger as the industry's arcane rules currently allow. The deal shows the determination of Europe's airlines to consolidate in order to survive; the EU-US talks could lead to the removal of obstacles to a more global consolidation of the industry.

This will have profound implications for travellers. In ten years' time there may be only a handful of multinational airlines left, all of them with seamless networks covering the globe. A visit to the website of one of them will be enough to book any trip in the world to any number of destinations. Beside these global giants will be a number of small airlines running business-only flights to a large number of places. There may also be supersonic Airbuses flying across the Pacific and a new low-cost carrier in Europe called easyAtlantic. Before this can happen, however, the industry will have to go through a period of accelerated evolution.

## Manifestly not open

Although the Air France and KLM brands are to remain separate, the partnership between the two (see article) promises to become more intimate than any other cross-border deal in the industry. Most airline alliances are little more than joint-marketing exercises, but the Franco-Dutch group plans to integrate its operations more fully.

Moreover, the partnership may not stop there. Alitalia, Italy's flag carrier, has expressed a desire to get closer to Air France, and both members of the new alliance made it clear this week that they would welcome a trilateral grouping. KLM has been seeking a partner for years. An attempt to link up with Alitalia fell through three years ago, just before a planned deal with British Airways was shot down by the

Americans. Washington indicated that, if BA took control of the Dutch carrier, the bilateral deal between America and the Netherlands would be cancelled.

The industry is riddled with such bilateral agreements between governments. They control market entry (which airlines can fly) and market access (where they can fly to). Mostly, they also govern frequency and the number of seats per flight. Some of the older ones still give governments power to intervene on prices.

The Americans feared that BA would use its link with KLM to gain more access to American destinations through a back door—ie, by flying direct from Amsterdam's Schiphol airport to, say, New York. In this week's deal, KLM and Air France have come up with an ingenious way by which they hope to circumvent the rules that tie traffic rights between two countries to domestically owned carriers. Although current Air France shareholders will own 81% of the combined holding company, 51% of the KLM subsidiary will actually be owned by Dutch interests for three years.

Clues as to America's reaction to the deal, which has to win clearance from both American and EU antitrust authorities, could lie in the EU-US talks that began in Washington on October 1st. The aim of the talks is to extend the liberalisation of transatlantic traffic. Until last year, such negotiations took place between America and individual European countries. But in 2002, the European Commission won a court ruling that the arrangement was unlawful on the grounds that, for instance, a German-American bilateral deal allowing only Lufthansa to fly transatlantic flights from Germany discriminates against airlines from other EU countries. Subsequently the EU's Council of Ministers voted to give the European Commission power to negotiate with America on an EU-wide deal.

That landmark ruling could change the whole of aviation, moving it from a regulated market of protected national flag-carriers to a truly global business where cross-border mergers and acquisitions are as commonplace as they are for banks.

America's tactic is to build on the bilateral deals it already has with 11 EU countries and to extend them to the whole union, from Greece to Lithuania, via a single agreement forged with the European Commission. Europeans, on the other hand, want a much more ambitious arrangement that would scrap all restrictions, end ownership rules and open access for their carriers to the huge internal American market. The commission wants to create what it calls an “open aviation area” covering Europe, America and the water between them. Under the pugnacious transport commissioner, Loyola de Palacio, the EU has conceived a plan to sweep away all regulations except those on technical and safety matters.

America has some more specific goals too, such as getting more of its airlines into London's Heathrow airport, the biggest international hub in the world. That privilege is at present reserved for United and American Airlines which inherited the rights of PanAm and TWA when those two old brands withdrew as their fortunes waned. But no amount of liberalisation can make that happen on its own; there will be little spare capacity at Heathrow until a fifth terminal and a third runway are built, and both are years away.

It would be a fitting commemoration of 100 years of powered, manned flight if the negotiators at their second meeting, scheduled to take place in Brussels a few days before the historic anniversary on December 17th, could start to untie the knots which have hobbled international air travel ever since it began.

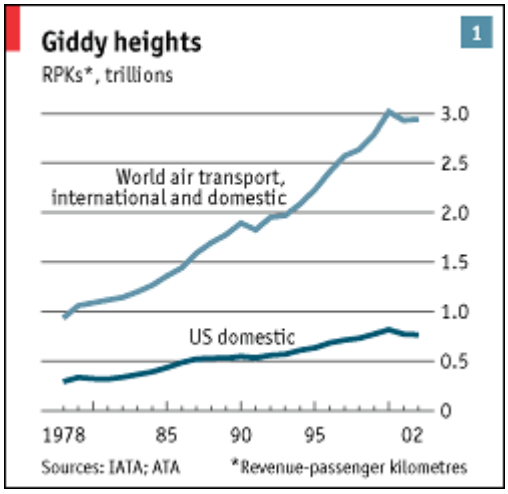
## Prussian-style deregulation

The regulatory mess that is international aviation goes back over half a century. At a conference in Chicago in November 1944, governments attempted to lay down the technical and legal rules for the post-war order in international air transport. America had been keen to establish a competitive regime with minimum regulation, not least because it saw the ability of its airlines to dominate such an industry.

But other countries at the conference refused to go along with this. They saw aviation as a matter of national prestige and sovereignty. Thus was born the arcane system of bilateral deals, which not only regulate direct traffic between pairs of countries but also control rights to pick up passengers at a destination and carry them on to a third country. All the various rights were curiously known as the “seven freedoms of the air”, pure Orwell-speak for the exact opposite. In aviation, as in Frederick the Great's Prussia, everything is forbidden that is not expressly permitted.

Alongside this legal bindweed went a tariff-setting arrangement organised through the International Air Transport Association (IATA). For more than 40 years IATA ran a sort of international cartel controlling the price of tickets. Once a pair of airlines had agreed fares through IATA, they had to be approved by both governments involved. Some of this collusion was (indeed, still is) necessary for pooling revenues where a passenger flies one leg of a journey on one carrier and the next part on another. But in practice it amounted to an amazing global cartel that made OPEC look amateurish. Air travel was for a long time limited to the rich because the fares were sky-high.

That first started to change within America itself, when the industry was liberalised in 1978. The federal government withdrew from economic regulation, and any competent airline was free to fly where and when it wanted at prices determined by the market. The result was an explosion in air travel, which rose by 150% over the next 20 years (see chart 1).




The most authoritative studies, done in the mid-1990s, of the effects of liberalisation within America showed that consumers benefited to the tune of $20 billion a year. Fares were 20% lower than they would otherwise have been, and 80% of passengers enjoyed lower fares, especially on routes flown by the new low-cost carriers, such as Southwest Airlines and AirTran (formerly ValuJet).

But the big network airlines gained too. They developed hub-and-spoke systems to suck up traffic from small markets and feed it on to bigger, cheaper flights between hub airports. This system, first developed by American Airlines in the 1980s, led to planes being three-quarters full instead of half-empty.

Europe took nearly 20 years to follow suit, but by 1997 the same rules applied within the EU. Any airline could set up anywhere and fly anywhere within the union's boundaries. At one point, BA was running subsidiaries in both France and Germany, though with little success.

The real achievement of Europe's deregulation was exactly the same as in America: the emergence of low-cost carriers, initially easyJet and Ryanair in Britain and Ireland but with imitators now taking off in Germany, Italy and Spain. The low-cost airlines are on their way to grabbing the same 25% share of the air-travel market in Europe that the pioneers of this approach already have in America.

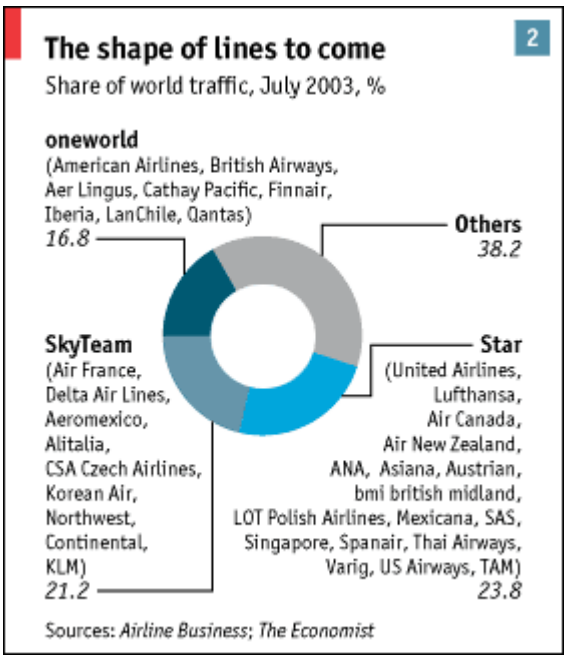
As Europe liberalised its internal market, America started signing up European countries for bilateral deals, starting with the Netherlands in 1993, but later covering France, Germany and some smaller countries. Although anything but open, these were dubbed “open skies” agreements because they were, at least, more liberal than the old-style arrangements. The country's carriers got to fly to more American cities than before, in return for allowing American carriers to fly from anywhere in the United States to more of its cities.

The two governments in each case dropped all restrictions on flights, capacity and pricing, opening the door to competitive fares. European nations' single flag-carriers were allowed to form alliances with American partners and were given immunity from American antitrust law to fix prices. Indeed, under the first open-skies deal, KLM and Northwest proceeded to pool their transatlantic flights and revenues in a close operating alliance.

The proliferation of such deals, not just with Europe, boosted the revenues of American airlines as the number of international passengers went up by nearly half in the 1990s, while internal traffic increased barely at all. A couple of studies showed that tickets booked through allied airlines on two-stage flights were 18-28% cheaper than separate flights on the same route with non-allied airlines.

But these deals are of more benefit to American carriers than to Europeans. American airlines can fly from anywhere in their own country to European cities, but a European carrier can fly only from its home base. Since the traffic rights they confer are restricted to airlines owned by the European signatory, they inhibit cross-border European integration (or have done so until KLM's attempt to wriggle through this week). No transatlantic merger is possible either, because America limits foreign shareholders to 24.9% of its airlines, while Europe limits non-EU ownership to 49%. Moreover, European carriers are not allowed to pick up passengers in one American city and fly them to another.

If Europe and America can shed these rules and completely liberalise their airspace, the rest of the world will be forced to follow. The two regions together account for well over half the world's air traffic. Global takeovers will then be possible, leading to consolidation and economies of scale. From this, a handful of mega-airlines could come to rule the skies.




## The appliance of alliance

This week's Air France-KLM deal indicates how a new global airline industry might emerge. Once the two hook up, KLM's existing American partner, Northwest, will join the SkyTeam alliance, one of the loose international groupings that airlines have formed *faute de mieux* (see chart 2). It will be followed by Continental Airlines (with which Northwest already does joint marketing inside America), and that will make SkyTeam a close rival to Star, the biggest of the international groupings. Together with oneworld, the three could, in a fully liberalised world, be the kernel of three global mega-carriers.

If the antitrust authorities ever tolerate anything like this, flight costs could come down sharply through economies of scale. Travellers around the world would then routinely enjoy the lower fares that they get now only on off-season deals and low-cost regional flights.

There is always a chance that the talks beginning this week will go nowhere. Although the Americans have been saying for some years that they are looking forward to negotiating with the European Commission on an EU-wide agreement, they might just be aiming to impose the same template of limited open-skies deals already signed with 11 EU countries and with almost 50 others outside the EU. “We sure do like our template,” said one American negotiator ominously when news came through last year of the commission's mandate to negotiate for the EU.

The Americans may prefer to settle for something else, even though there is a feeling in the industry that it is high time to apply free trade rather than just pay lip service to it. The most vocal proponent of total liberalisation of air traffic is Fred Smith, boss of the global air-freight company, Fedex. But leading figures such as Don Carty (until recently chairman of American Airlines) and Rod Eddington (boss of BA) have called for aviation to join the world's free-trading system rather than stay stuck in its time-warp. Even IATA, for long a pillar of the regulated system, is now campaigning for free trade. The danger, as one European airline executive puts it, is that the American airlines “right now have enough on their plate simply trying to survive.” They are set to make losses of around $5 billion this year.

There are plenty of sceptics around. Although BA says it is in favour of the EU's total liberalisation, it might be leery of proposals to open up Heathrow too much. In America, the airlines' unions have great power, and they are sure to oppose the opening of domestic American traffic to foreign airlines. And critics of the EU vision say that such a wholesale re-drawing of the aviation map will stall in disputes over the many intricate details involved, such as concerns about the oversight of safety, technical and security matters.

There are political obstacles too. Ms de Palacio's replacement when she vacates her transport commissioner's chair next year might be some time-server with no drive to push for the same vision. Besides, nothing much can happen before America's presidential election next November.

In the short term, the best that can be expected is for a series of working groups to be set up next spring to find a way to implement an open aviation area. The EU has calculated that such an area across the Atlantic could benefit consumers to the tune of €5 billion ($5.8 billion) a year, and help carriers by stimulating traffic and facilitating consolidation. It will be a long and difficult journey, but consumers should not forget what they have to gain from reaching the destination.

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**Air France-KLM**

# A bet on the future

Oct 2nd 2003
From The Economist print edition

### At last, a cross-border merger of airlines

AFP

**Praying for a tailwind**

**Get article background**

NO ONE could accuse Air France of going for short-term gains by hooking up with KLM, an airline half its size. Shareholders in the French national carrier, 54% owned by its government, are paying €784m ($913m) to acquire four-fifths of the Dutch carrier. Last year KLM lost €271m while Air France made pre-tax profits of €111m.

There is the *gloire* of owning what will be the world's largest airline, measured by sales. But the deal offers little prospect of reducing costs, says Chris Tarry, an independent aviation consultant. The comfort is that it makes few demands on cash. Air France is paying in shares and will not have to pump capital into its new partner.

The merger (in all but name) certainly helps KLM, whose credit rating has sunk as it has scoured Europe's airlines looking for a safe haven. Its shareholders are being offered a 40% premium on the share price the day before the announcement (a price already inflated in anticipation of a deal).

The two airlines will be owned by a joint holding company, but will operate as separate brands from their bases in Paris and Amsterdam. There are no plans for rationalisation or cut-backs other than those already in the pipeline for the loss-making KLM. Instead, Air France's boss, Jean-Cyril Spinetta, seems to have his eyes on the blue yonder. “It's a bet,” says Keith McMullan of Aviation Economics, a London consultancy, “on the outcome of the EU-US talks on an open aviation area” (that began in Washington, DC, this week—see article). In fact, it puts some pressure on the EU negotiators to speed up the talks.

For the next three years, two Dutch trusts and the Dutch government will own 51% of the voting shares of the KLM operating company in order to safeguard its traffic rights under its existing bilateral aviation agreement with the United States. The (optimistic) hope seems to be that the EU-US liberalisation talks will have swept away all such restrictions by the end of that period.

By snapping up KLM, Air France will dominate two of the four long-haul hubs in Europe (the others are Frankfurt and London's Heathrow). Once it is free to behave like any other business, Air France-KLM could have a great future. Until then, Air France may have cause to rue this week's acquisition.

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Commodities

# A copper-bottomed boom?

Oct 2nd 2003
From The Economist print edition

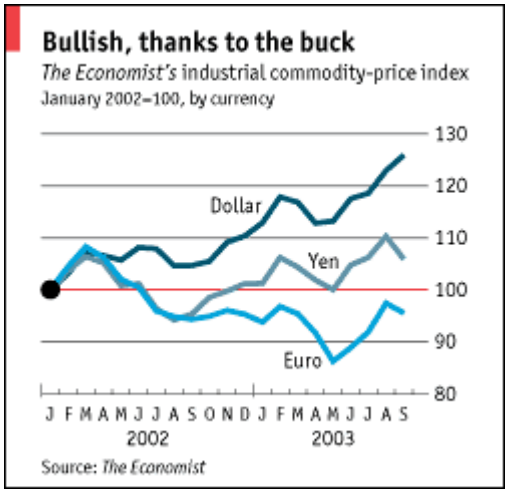
Alamy

**The prices of commodities are rising steeply. There is a bit less to this than meets the eye, however**

COMMODITY prices are showing new zest. Copper, often seen as a harbinger of economic trends, is trading in the futures market at 30-month highs. The formerly boring market for nickel is at a three-year high. The price of platinum is at a 20-year peak: the car industry, one of its biggest consumers, is turning out lots of vehicles, if unprofitably. Gold fetches more than it has for seven years.

Not so long ago, in the 1990s, the long decline of commodity prices seemed to be supporting a pleasant new world of strong growth and low inflation. In those days, as stockmarkets boomed, the word "commodity" took on a new meaning. American business consultants, in the age of the new economy, took to using the C-word as a pejorative for almost any product, service or skill that had become standardised (or just looked as if it might) and thus doomed to low margins and shrinking prices. Now that the share bubble has burst and a recent surge of interest in bonds has waned, commodity markets are again having their day.

*The Economist*'s industrial commodity-price index, which since 1864 has tracked the prices of stuff dug out of the ground, forged and smelted, has risen by 25% since the start of 2002 in dollar terms (see chart). In part, this increase seems to reflect growing confidence about global economic growth. Commodities are the first part of the manufacturing chain, and serve as a leading indicator of a pick-up in production. But by no means all of the rise in commodity prices can be chalked up to brighter growth forecasts.




Currency movements have also had a marked effect on commodity prices. The dollar's weakness over the past year, not to mention in the past few weeks, has done much to flatter commodity markets. Most commodity prices are quoted in dollars, whether they are traded in London or mined in Lusaka. For buyers of commodities in America, for example, prices certainly look higher. Buyers in the euro zone, however, are enjoying lower prices in terms of their own currency than at the beginning of 2002. Prices in yen are only a little higher than at the start of last year.

Those currency effects are also at work, albeit in a slightly different fashion, in the gold market, which

has perhaps caught most attention recently. Gold bugs have been triumphant as the yellow metal has brushed almost $400 an ounce, a price not seen since the mid-1990s. Traditionally, gold has been thought to be a hedge against inflation. With inflationary risks low, this scarcely explains its recent popularity. More likely, the rise in the gold price says more about the dollar than about gold. In euro terms, for example, gold prices have barely budged.

## Base effects

The rising prices for base metals, such as copper, nickel and aluminium, are probably more significant. These owe much to a manufacturing rebound in Asia, especially in China. As production increases to meet the requirements of recovering global growth, demand for metals of all sorts is also growing. According to Capital Economics, a London consultancy, the full implications of growing demand from China and from rich countries are not yet reflected fully in commodity prices.

By raising commodity prices, China's booming economy has also helped those of other poor countries, which have long suffered as the prices of their main exports have withered. Chile and Peru have benefited from copper's rise. Buoyant nickel prices are a big boon to Russia. Dearer gold and platinum help African miners. The government of Ghana, for example, stands to earn a great deal more from the sale of its stake in Ashanti Goldfields, a mining company, than it did just a few months ago, thanks to rising gold prices.

For all the optimism, however, there is reason to be wary of claims that this is the beginning of a long bull run in commodities. In commodities, every bull market contains the seeds of its own destruction. Vietnamese coffee producers planted seedlings in the early 1990s, when prices were robust. As their harvests began to grow later in the decade, prices slumped. Much the same is true in metals industries, where rising prices lead to the opening of previously shuttered mines. Even as the gold market rises, it is watching for sales by central banks. Much of the recent increase in base-metal prices reflects producers' slow response to signs that the global economy is picking up. When they do respond, a flood of new output is to be expected, followed by falling prices. Oil has so far been the only commodity whose producers have been able to prop up prices by maintaining a cartel.

One extra factor pushing prices upwards is speculative buying. Hedge funds, in particular, have been keen. Many such investors, as well as more staid pension funds, whose staple fare is equities and bonds, have noted commodities' new allure and have piled in. Their bets are made easier by recently constructed indices in steel and gold. Some also suspect that hedge funds have increased the volatility of some markets: last year, a fund called Armajaro was reported to have taken a huge stake in the global cocoa market, just as prices reached 15-year highs. But mostly, their impact should be the opposite. The greater liquidity provided by such investors should reduce volatility, smoothing out any demand shocks.

Whatever the role of hedge funds, once institutional investors have piled into such “alternative” assets, it should mean that the end of the bull market cannot be too far away. Nevertheless, if the dollar continues to slide, prices could continue to rise in dollar terms for some time yet.

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**Alarm signals**

# America the risky?

Oct 2nd 2003
From The Economist print edition

**The results from an economic early-warning system**

WITH an eye to the crises that have erupted in emerging markets in recent years, the clever economists at Lehman Brothers have produced a model to help prevent investors losing their shirts again. The model, called Damocles (as in “sword of”), is an early-warning signal. It puts together ten indicators—from external debt as a percentage of GDP to foreign reserves as a percentage of short-term debt—to assess the overall riskiness of a country, which is expressed as an index.

The bank picks a number for each of the factors; a rise above that number is reflected in the index. The choice of the factors, says the bank, involves theory and experience in equal measure; their weights are derived by looking at their contribution to crises in 15 emerging-market economies since 1995. A reading above 75 indicates that a country has a one-in-three chance of a crisis in the next 12 months; a figure above 100 implies a 50-50 chance.

As is generally the way with such models, Damocles has worked well when tested on past crises: it would have predicted the Asian crisis of 1997, for example. In recent years, the index has fallen for just about every emerging market except South Africa. There is, however, a bigger exception, a country that is not normally bracketed in such company: America.

When Lehman ran America's economic numbers through Damocles, the outcome was striking. With its rapidly climbing current-account deficit and foreign debt, among other worries, America's Damocles index is just shy of 75. There are, points out Russell Jones, the bank's international economist, problems applying Damocles to America, which enjoys the luxury of having the world's reserve currency. Granted. Poorer countries tend to owe dollars, and therefore suffer when their currencies fall. Lucky America, of course, owes its own currency.

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American life insurance

# A Boston marriage

Oct 2nd 2003
From The Economist print edition

**Will more mergers follow Manulife's purchase of John Hancock?**

THEY are not, in fact, related. But Dominic and David D'Alessandro will soon be part of the same corporate family. On September 28th Manulife Financial, a Canadian life insurer of which Dominic is chief executive, said it would buy John Hancock, a Boston rival run by David, for $11 billion in shares. The deal, the biggest takeover ever by a Canadian company, will make Manulife the sixth-biggest life insurer in the United States by premiums (see chart) and the number two in Canada.

The deal came eleven days after AXA, a French insurer, announced the takeover of MONY, a New York life insurer, and three days after Fortis, a Dutch-Belgian financial group, said it would float its American insurance operations. On September 30th Safeco, a Seattle insurer, said that it wanted to sell its life-insurance and investment-management arm. Was all this coincidence, or is there more activity to come?

Once Canada's biggest insurer, Manulife has dropped down a few rungs after mergers among its competitors during the past year. If it wanted to grow, Manulife had little choice but to head south. No big insurers were left on offer at home. In the past a merger with the Canadian Imperial Bank of Commerce had been mooted, but Canada's government discourages mergers of insurers and banks.

In contrast to the Canadian market, American life insurance looks ripe for consolidation. There are still about 1,500 life insurers. A host of small and middle-sized companies operate alongside five behemoths, such as American International Group and Metropolitan Life, which have one-fifth of the market. Many consider size an advantage in life insurance because of cost savings in technology, distribution or the back office. The Manulife deal is the beginning of a new wave of consolidation in American life insurance, says Nigel Dally at Morgan Stanley in New York.

But who are the likely buyers of American life insurers? After losing billions from stockmarket declines in recent years, European insurers, which used to be heavily invested in equities, do not have any spare cash and have lost interest in acquisitions. Fortis was only the most recent European firm to retreat from the American market. Zurich Financial Services, Royal & Sun Alliance and Skandia have all partly or entirely withdrawn from the American market. The recent raid by AXA, already a biggish player in the American market, is an exception. American insurers do not have much extra money either, thanks to state regulators' strict rules on their investment policies and capitalisation. Japanese life insurers are in a state of permanent crisis and Canada's life insurers (aside from Manulife) have until recently been busy merging with each other.

Joan Zief of Goldman Sachs and Michael Cohen of A.M.Best, an agency that rates insurers' creditworthiness, both agree that more acquisitions are likely to follow the Manulife and AXA deals. Many insurers, like MONY, have demutualised and can now be taken over, says Mr Cohen. Yet other analysts argue that, as long as they are well run, smaller insurers can remain independent and compete with the industry's biggest firms.

American life insurance went through a wave of consolidation in the 1970s, when dozens of companies

went under because they had taken on too much risk and invested their assets unwisely. This time consolidation—if it happens—will be triggered not by companies going bankrupt, but by businesses trying to compete more effectively. Meanwhile, in Europe life insurers will be merging too. However, for many European firms the choice will be more stark: merge or go bust.

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**Bank regulation**

# Blockage in Basel

Oct 2nd 2003
From The Economist print edition

**New rules for international banks' capital have hit an obstacle**

BY NOW Basel 2, a new set of rules on international banks' capital, should be almost complete. In essence, the idea is to improve banks' stability by tying their capital more closely to the riskiness of their assets. The committee drawing up the regulations has been working for five years, and should finish by the end of this year if Basel 2 is to be implemented as planned at the end of 2006. Yet the chances of this look slim. The proposals as they stand have many critics. Banks say they are too complicated. Standard & Poor's, a rating agency, says that it might downgrade banks whose capital it deems inadequate, even if the banks comply with Basel 2. China and India have opted out entirely. More troubling, American banks and their regulators are also unhappy.

A committee meeting scheduled for October 10th is likely to confirm that delay, not a deal, is in the offing. The stumbling block is American banks' dissatisfaction on several technical but important questions. “The greatest threat to an accord is from those who want to paper over major problems,” says John Hawke, head of the Office of the Comptroller of the Currency (OCC), a regulator of American banks.

The Americans are disgruntled by the definition of capital under the new rules—and therefore by the amount of capital Basel 2 implies that banks should set aside. In particular, they are concerned about capital charges for losses on bad loans. Existing practice requires banks to make capital charges for unexpected losses. Expected losses are dealt with differently, through provisions (a charge against profits every quarter) and pricing (the riskier the borrower, the higher the interest rate). Two years ago, the Basel committee agreed that there should be capital charges for expected losses too.

Partly as a result of a recent “impact study” of Basel 2's likely effects, the magnitude of this new charge has become clear. American banks, which do nicely from credit-card and small-business loans, on which expected losses are high, now want to unpick the proposal. Their regulators want another impact study and more time to sort out the rules.

Europeans are furious that such basic questions are being debated anew this late in the day. A German regulator spoke this week of “Pandora's box” being re-opened. European lawmakers have a timetable to pass legislation on bank capital in parallel with the introduction of Basel 2. They still plan to make the new rules binding for all European Union banks and investment firms even if Basel 2 is delayed indefinitely.

On one reading, the whole Basel 2 process is in jeopardy. America already plans to apply it to only 12 banks, with another dozen expected to comply voluntarily. Developing countries might follow China's and India's lead. Yet an obituary may be premature. Basel 2 is meant to apply to “internationally active” banks. America's two dozen comprise 99% of that country's banks' foreign exposure. Few developing-country banks qualify. Moreover, most banks and regulators (including Americans) agree that the existing rules, known as Basel 1, should be updated.

At some point, therefore, some sort of deal will probably be thrashed out. The question is whether this will take weeks or years: the answer depends on whether the Americans are willing to seek a quick compromise. The Americans themselves disagree about this. The Federal Reserve is keener on a deal than the OCC.

Even if the wrangle about expected losses is sorted out, regulators have other important issues to deal with. More work is needed on co-ordinating national supervisors, who are given wide discretion to tweak the rules. This can lead to inconsistency and even outright favouritism. Closer links with emerging international accounting standards, which will also apply across the European Union, would also help.

Critics also say that the committee should think harder about the unintended consequences of Basel 2. The new rules, say some, might exacerbate economic downturns by forcing banks to cut lending and raise capital when the cycle is weakest. Others worry that the regime will discourage banks from well-calculated risk-taking. And then, somehow, the complicated new system will have to be enforced. A delay may be the least of the new accord's problems.

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The SEC and hedge funds

# Rules for the unregulated

Oct 2nd 2003
From The Economist print edition

**America's SEC draws up a new regime for the hedge-fund industry**

### Shining a torch

The SEC's hedge-fund report recommends:

- requiring hedge-fund advisers to register as investment advisers; this would raise the minimum investment of their clients to $750,000 or their minimum net worth to $1.5m
- requiring all registered investment firms to value their hedge-fund investments according to federal securities laws
- requiring all registered investment firms to disclose the estimated expenses of their hedge-fund investments
- permitting general advertising by funds whose clientele is limited to "qualified purchasers"

Source: SEC

FINANCIAL folklore has it that hedge-fund managers are blessed with nerves of steel. Yet when America's Securities and Exchange Commission (SEC) announced an investigation of their largely unregulated industry last year, managers became a mite fretful as they contemplated curbs on their investment strategies or the enforced disclosure of their trading positions.

They need not have worried. The SEC's proposals, published on September 29th, fall far short of realising the industry's worst fears. After 16 months of consultation and deliberation, the agency's staff have recommended that hedge funds register with the SEC under the Investment Advisers Act (IAA) of 1940, as ordinary asset managers must do. Their report also proposes that investors should fulfil more demanding conditions than they do now in order to invest directly in hedge funds. It says that hedge funds should value their investments according to IAA rules. The agency will also ask for more information on hedge funds' management and performance fees. In one area, the SEC even wants rules relaxed: advertising by funds sold to investors with $5m or more to spare should no longer be restricted.

Most fund managers had expected mandatory registration and the new informational requirements. The minimum qualifications for investors might have been worse. The SEC says that investors in hedge funds must have net worth of $1.5m or $750,000 in a single hedge fund; at present, they must have only $1m in the bank or an annual income of $200,000. Some pessimists, however, had feared that the new minimum would be $2m.

Contrary to the industry's fears, the SEC is not proposing restrictions on short-sellers (who sell securities they do not own) or on leveraging a fund (buying securities with borrowed money). It recommends only that the agency further examine the use of hedge-fund strategies. Nor will the SEC force hedge funds to reveal their books to the public. This, managers say, would have put their investment strategies and trading positions in jeopardy.

Why did the SEC take such pains over an obscure industry catering mainly for the very rich? One reason is hedge funds' rapid growth. In 1969, a mere 200 of them managed perhaps $1.5 billion. Now there are 6,000-7,000, running about $650 billion. William Donaldson, chairman of the SEC, thinks that the industry will manage $1 trillion within five to ten years. Smaller investors are beginning to put money into hedge funds, albeit indirectly. They might need more protection than the ultra-rich. And a few funds

have blown up spectacularly in recent years. The SEC hopes that the new rules will deter fraud: it intends to scrutinise hedge funds' portfolios and records, and to check operations on-site.

The proposals will come into effect by the end of the year if a majority of the SEC's five commissioners approve them. Mr Donaldson would prefer a unanimous vote. Two commissioners have expressed reservations, and are also reported to be unhappy at the language of a press release issued by the SEC on the hedge-fund report. These commissioners think policing hedge funds will divert the SEC's attention from the much bigger mutual-fund industry, which oversees about $7 trillion. Moreover, they argue, hedge funds' clients are still mostly sophisticated investors who do not need the agency's protection.

Some make a different criticism. Without big increases in budget and staff, the SEC's policing of hedge funds will be prone to being incomplete, says Jedd Wider of Orrick, Herrington & Sutcliffe, a law firm in New York. A bit more transparency and regulatory oversight may be better than none. But the SEC may have created a new problem: some investors will see the agency's involvement as a sign that hedge funds are “safe”. Yet the industry will stay much as it is: a place for the steely-nerved, not neophytes.

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**Donaldson, cautious hedge-trimmer**

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**Hedge funds in India**

# Unwelcome guests

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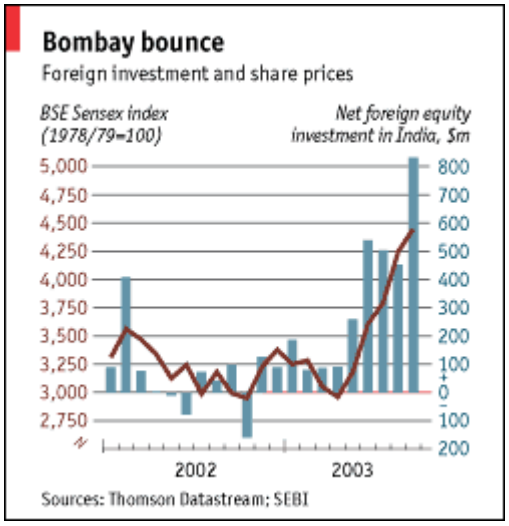
From The Economist print edition

**The interest of hedge funds is unsettling India's regulator**

FOREIGN investors are charmed by India these days, and no wonder. The government is stable, domestic consumption is strong and inflation is in check. Since May foreign institutional investors have pumped $2.6 billion into Indian equities—more than three times the inflow in the whole of 2002, according to the Securities and Exchange Board of India (SEBI), the market regulator. The stockmarket has risen by 51%.




But SEBI is more worried than pleased. Much of the foreign money has come from hedge funds that have bypassed its gaze. Although a few hedge funds had invested in India soon after the country began liberalising its financial markets in the early 1990s, their interest has surged recently. Industry sources estimate that perhaps 25-30% of all foreign equity investments are now held by hedge funds.

Hedge funds like India because it is one of the few emerging markets to offer such sophisticated products as futures and options on single stocks and stock indices. However, only foreign investors registered with and regulated by SEBI are allowed to participate in the markets. To get around this, hedge funds route their investments through registered investment banks, which buy securities and sell synthetic products based on them to the funds. Among these are “participatory notes” or P-notes, which track the performance of a pool of securities and are listed in Luxembourg. The investment banks own and trade the underlying securities on their books, making the whole set-up look above-board.

But SEBI got wind of this. It worried partly that unauthorised investors were playing in India's markets, but also about the effect of hedge-fund investments on the rupee and financial stability: huge inflows push a currency up, but also make it vulnerable to collapse if the money rushes out again. So it issued “proposed” guidelines which would allow it to monitor P-note trades, which had hitherto not had to be disclosed.

After much dithering, SEBI said in August that foreign institutional investors would have to disclose the total value of outstanding P-note contracts and the identities of their buyers fortnightly. Although this allayed fears among some hedge funds and banks that P-notes would be banned, the new rule is still an irritant, because it forces the revelation of certain kinds of trade. In India investors are not allowed to short-sell equities (ie, sell shares they do not own) for speculative reasons. But some hedge funds have in effect been doing precisely that, disguising shorted P-notes as hedges against the underlying long positions of investment banks.

Hedge funds have other reasons for grumbling about SEBI. The processing of applications to register as a foreign investor in India takes much longer than the promised ten to 12 days. Between one month and three is nearer reality, during which time markets can soar or swoon. If it were less painful, many hedge funds say, they would register.

So far, the hedge funds have not been put off by the new rules. In fact, their activity has increased. And some Indian broking houses think that the legitimisation of P-notes will attract other kinds of foreign investor, who were previously reluctant to use them because of the uncertainty surrounding their regulation. The new guidelines, they say, might bring in foreigners in even bigger numbers.

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Economics Focus

# An adventurous economist

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From The Economist print edition

**Franco Modigliani, who died aged 85 on September 25th, left a rich intellectual bequest**

SERENA MODIGLIANI warned her husband not to turn around if someone shouted his name on the streets of Rome. “Otherwise they'll shoot you,” she said. It was the winter of 1978, and Italy was gripped by political violence and economic chaos. Franco Modigliani, an economist at the Massachusetts Institute of Technology, had returned to the country of his birth to take part in a televised debate, urging unpopular reforms.

When Mr Modigliani left his hotel the next morning, he heard a man behind him call his name. He tried to walk faster, but his pursuer drew nearer, and finally caught him, grabbing his jacket. An assassin? No: a cobbler, in fact, desperate to tell him that, of all the bigwigs on the television the previous night, Mr Modigliani had been the only one to say “anything comprehensible”.

With Mr Modigliani and Charles Kindleberger (see article), the economics profession has recently lost not only two of its best minds but also two of its finest communicators. Few economists leave a single mark, yet Mr Modigliani left several, for which he won a Nobel prize in 1985. He crafted a theory of people's saving decisions, which is how most undergraduates first hear of him. His insights into corporate finance launched a revolution in the valuation of companies.

Before Mr Modigliani came along, economists regarded saving as largely the preserve of the rich. For poorer people, how much they spent and saved depended on their current income. Thus Keynes wrote in his “General Theory” that it was a “psychological law” that saving rose with income. Moreover, to Keynes and his followers saving was as much vice as virtue: in the Depression, it seemed that people were holding back, and were not spending enough to keep the economy going.

Mr Modigliani was sceptical of this thinking. He noted that the whole story of economic growth and development was one of accumulating capital through thrift. That led him to create—with Richard Brumberg, a graduate student—a more detailed model of how and why people save.

The upshot was the “life-cycle hypothesis”. In essence, this says that people save during their working lives in order to spend when their income wanes in old age. In a similar way to Milton Friedman's “permanent income hypothesis”, which was developed at about the same time, Mr Modigliani's theory supposes that people base their saving on their expected incomes over their whole lives. Thus they save more when their income is above its expected lifetime average because of transitory shocks, such as an unexpected bonus or a few high-earning years. This may sound obvious now, but the mere idea that people at all income levels forecast their expected lifetime income and save accordingly gave economists a way to model saving—and its counterpart, consumption—mathematically. In the policy arena, any debate about, say, today's pension crisis in rich countries owes much to Mr Modigliani.

Mr Modigliani later put his talent to work on another problem. In the early post-war years, the study of corporate finance was in its infancy. Questions of how much debt was optimal for a company, or what the effects of a change in dividends would be, were typically left to grey-flannelled businessmen to chat about over three-martini lunches. However, with Merton Miller, a fellow Nobel laureate, Mr Modigliani worked out that, assuming perfect capital markets and tax neutrality, the amount of debt a company has is immaterial.

That is because investors base their valuation of a firm on its profits, not the details of its financing. If a company takes on too much debt, making it more risky, investors can take this into account when choosing their personal portfolios. They see through a company's mix of debt and equity

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(unless, of course, it is obscured by Enronesque devices) and value it appropriately. Nowadays this theory, known as the first Modigliani-Miller proposition, is taught to business students everywhere.

By a similar logic, the pair devised a second proposition: that dividend policy is also irrelevant. It makes no difference to investors whether a company pays out all its profits to shareholders or keeps and reinvests the lot. In practice, tax systems skew companies' decisions. America's tax system has led companies to pile up debt and until this year favoured capital gains over dividends.

## An independent mind

Despite his technical gifts, Mr Modigliani showed little appetite for mathematics at school. As he recalled in his autobiography, “Adventures of an Economist”, he received help in the subject. This allowed him to pass his exams early. He left Mussolini's Italy in 1938. Once in America, he took to maths only after seeing its value to the study of economics. Many economics students since have reluctantly learned the same lesson.

In an age of politically partisan economists, Mr Modigliani maintained his independence. He opposed America's war in Vietnam, but praised Ronald Reagan's cold-war victory for freeing millions from “slavery”. He was an implacable foe of the Gipper's economic policy, criticising what he saw as insane deficits and tax cuts for the rich. Yet he was contemptuous of Italy's high tax rates, which forced ordinary people to become tax-evaders merely in order to live decently. George W. Bush's deficits also drew Mr Modigliani's scorn, as did Mr Bush's recent plans to privatise America's social-security scheme. He argued that private accounts would create more risks and inequalities, but no new incentives for hard work or thrift.

One assumption of his life-cycle hypothesis was that people saved mostly to take care of themselves, rather than their heirs. That seems to have explained the real behaviour of people quite well. Yet the theory fits Mr Modigliani's own life extremely poorly. Generations of students have learned from his work, and the entire economics profession is the richer for it.

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Archaeology

# What lies beneath

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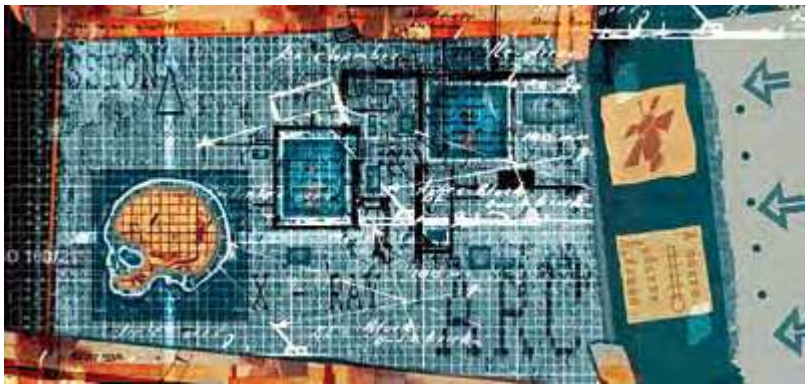

**New “non-destructive” sensing technologies are transforming archaeology**

SINCE its emergence as a science, archaeology has wrestled with a paradox: discovery involves destruction, and investigation requires intrusion. An archaeological dig cannot be undone. Once a layer has been stripped away, any information not recorded is lost. Most archaeologists have had the experience of trying to discover something new about a site that has been completely excavated, only to find that the question they wanted to ask had not occurred to the original diggers.

So knowing what lies beneath the surface before the trowel hits the soil has long been the dream of many an archaeologist. As well as saving time in determining where to dig, it would enable archaeologists to answer questions with a minimum of destruction—and potentially none at all. This dream is slowly becoming a reality, as a result of improvements in non-destructive surveying techniques. Archaeology has never been a wealthy discipline, but by borrowing tools developed for more well-endowed professions, archaeologists are developing X-ray vision—or, to be precise, infra-red, microwave and magnetic vision, which are even better.

Such tools enable archaeologists to identify and target small areas of interest, and to move away from the complete excavation of sites towards a more selective approach. This method, known as the “conservation model” of archaeology, means that archaeological resources are maintained for future generations, who will be armed both with novel technologies and new questions. As sensing techniques improve, archaeologists are also benefiting from the tumbling price of computing power, which enables them to combine, overlay and analyse data from multiple sources, yielding further insights.

## Seeing through new eyes

To demonstrate the potential of such techniques, a group of archaeologists from the University of Arkansas, led by Fredrick Limp and Kenneth Kvamme, have been investigating the site of Army City in Kansas. Established in 1917, it was a bustling town, complete with hotels and theatres. In 1921 it burned to the ground, leaving no trace of its former existence. Or so it appeared. But last year, when the archaeologists began to map what is now an empty hayfield, they found that they could see the precise locations of roads, pavements and rooms of buildings. They could even trace the sewage system. “It was almost as though the soil was transparent,” says Dr Limp.

The team combined several techniques. A ground-based magnetic gradiometry survey, which measures variations in the magnetic properties of the soil, detected buried sewage pipes containing iron. Variations in the magnetic polarity even revealed joins where one pipe met another. An electrical resistivity survey,

which works by passing an electric current through the ground, detected buried pavements and bricks, which are more resistant to electricity than the surrounding soil. These observations, and the results of other ground-based surveys, were combined with traditional aerial photography.

The next step, says Dr Limp, is to make use of satellite photography too. At the moment, he says, the resolution of publicly available Earth-observation satellites, such as *Landsat-7*, is often too poor to provide the necessary detail of an excavation site. But he thinks that new commercial satellites will provide sufficient magnification. His team is still processing data acquired from one such satellite, *QuickBird*, of the Army City site in July. It can see objects as small as half a metre across.

The use of commercial satellites is still beyond the budgets of many archaeologists. But their potential is significant. Dr Limp suggests that they could liberate archaeology from its current focus on areas of a few square metres and allow sites spread over many hectares to be analysed in detail. Payson Sheets and his colleagues at the University of Colorado, for example, have started to use data from another commercial satellite, *Ikonos*, to map ancient footpaths in Arenal, Costa Rica. By studying the patterns in their layout, the researchers hope to make connections between cemeteries and villages, which may provide clues about the former inhabitants' behaviour.

## The heat is on

Another technology that archaeologists are taking to is thermal imaging. This employs high-resolution cameras that are sensitive to the so-called near infra-red. This part of the infra-red spectrum, with wavelengths close to that of visible light, carries heat energy. Thermal imaging thus records slight differences in temperature. Such differences at the surface are often tell-tales of what lies beneath. A stone foundation, for instance, retains heat differently from a pit that holds moisture.

One such camera, used by Dr Kvamme and his colleagues, can monitor temperature differences as small as 0.1°C. In August, Dr Kvamme tested this camera at Double Ditch, a prehistoric fortified settlement along the Missouri River in North Dakota. Initial results, though not fully analysed, have turned out to be “shockingly good”, according to Dr Kvamme. The researchers were able to see the boundaries of houses previously unknown to them, and were even able to make out the doorways of these dwellings. Two of the site's four fortification ditches were also better defined by the thermal data. Because of these discoveries, the researchers have realised that the settlement was far larger than originally believed. Indeed, according to Dr Kvamme, it should really have been named “Quadruple Ditch”.

Dr Kvamme's technique is passive, since it relies on what nature provides in the way of heat. Dan Blumberg of the Ben-Gurion University of the Negev, in Beer Sheva, Israel, has a more forceful approach. He pumps the ground full of microwaves, to see what gets reflected back. Man-made objects buried under shifting sands, such as pipes or water aqueducts, are particularly good at reflecting microwaves. Indeed, in one of the early successes of remote archaeology, Ronald Blom and his colleagues at NASA's Jet Propulsion Laboratory, in Pasadena, California, used short-wavelength microwaves in 1992 to reveal caravan trails leading to the lost city of Ubar in the Arabian peninsula.

The signs of those trails were, however, near the surface. Dr Blumberg is putting his faith in a part of the microwave spectrum called P-band radiation. This has longer wavelengths, which means it can penetrate further underground. To prove this point, he and his team buried aluminium squares at different depths under the sand of the Negev desert in southern Israel. They then flew an aircraft carrying a P-band microwave radar over the area. By comparing the results with the squares' known positions, the researchers demonstrated that the patterns detected by the microwaves really did show the positions of the buried pieces of metal.

At the moment, the earth-observation satellites which employ microwaves generally use short-wavelength radiation, because this provides more detailed images. According to Dr Blumberg, though, adding P-band radar to satellite sensors should allow them to detect buried objects efficiently too. The European Space Agency, he says, is considering such a mission. The snag is that microwaves can only penetrate the ground in dry areas, because water absorbs them.

Such advances in sensing techniques are certainly welcome, and are helping to change the nature of archaeology. But Dr Limp reckons that there is just as much scope for improvement in using computers to integrate different sorts of observation. He and his colleagues have made a start on this at Army City, where they are creating a system that will swallow, digest and combine data from satellites, aircraft and ground-based sensors, aligning them in a single, computer-based model of the site. The system, he says,

should be fully functional next year.

This kind of approach should not only yield better results, but could also help archaeologists to decide which combination of sensing technologies is best suited to the conditions at a particular site. They could then identify and focus on areas of interest, decide what to excavate—and determine what to leave behind for future generations of their profession, who will have even cleverer gadgets at their disposal.

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**Asthma**

# Cure or curse?

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**Giving babies antibiotics makes them more likely to suffer from asthma**

EVERYTHING from air pollution to urine in swimming pools has been blamed for the dramatic increase in asthma over the last few decades. It is a vexing problem: since the 1970s, asthma rates in the developed world have been rising by about 50% a year. What used to be a relatively rare condition is now troubling some 150m people worldwide.

Now a team of researchers has shown that being given antibiotics as a baby seems to play a role in the development of asthma. It is not the first time that this link has been examined. But this study distinguishes itself from previous ones by following the children carefully from birth through to the age of seven, and by making a point of not relying on parents' mangled memories of when or whether their rasping, hacking, ear-infected infants took drugs for their ailments.

Instead, the researchers, led by Dr Christine Cole Johnson, an epidemiologist at the Henry Ford Hospital in Detroit, were more direct and less trusting. They called the parents of the 448 young research subjects by telephone to inquire about their kids' health at the ages of one and three, and visited them at home at the ages of two and four (pausing to sample household air and dust). In addition, the researchers collected details of how many pets roamed about the house and recorded whether and for how long each child was breastfed—both touted variously as risk factors and protectors.

They also checked doctors' notes to see if the children had been prescribed antibiotics. If so, the researchers distinguished between the so-called “broad spectrum” variety of antibiotics, which includes penicillin combinations, or the narrower varieties, such as individual penicillins and macrolides. Finally, when the children reached the age of seven, the researchers gave them full medical examinations, keeping an ear out for signs of asthma. Dr Johnson and her colleagues were specifically interested in what is known as “atopic asthma”, a type of asthma related to allergies.

Half the children had taken oral antibiotics within the first six months of birth. Dr Johnson found that those who had taken them were over two and a half times more likely to suffer from asthma later on in childhood than those who had not. More worryingly, the more courses of antibiotics taken—and about half of those treated were given several courses—the greater the risk. The antibiotics conferring the greatest risk were the broad spectrum variety. The researchers also found that early antibiotic use was associated with a wide range of allergies.

Dr Johnson, who presented these findings this week at the European Respiratory Congress in Vienna, concludes that antibiotic use at the beginning of life is mucking up infants' immune systems, malfunctions of which manifest themselves in the form of asthma and allergies. No one is sure exactly how infants' immune systems learn to distinguish good bugs from bad, but killing off too many gut bacteria—even, apparently, ones that cause illness—does appear to disrupt the process.

The idea that childhood infections help to reduce the probability of chronic diseases in later life by somehow “tuning” children's immune systems is known as the “hygiene hypothesis”. It suggests that the growing incidence of chronic problems in the rich world is a consequence of better hygiene and access to medical treatment, both of which reduce the incidence of childhood infections, and affect the immune system early in life. As evidence for this hypothesis grows, it is becoming more popular—and not just among scientists. Mothers with sticky kitchen floors and furniture lined with cat-hair love it too.

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Fuzzy logic

# This headline is (half) false

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**A new way to analyse self-referential and contradictory sentences**

EPIMENIDES the Cretan, a philosopher of the 6th century BC, is said to have uttered the sentence, “All Cretans are liars”. As he himself was a Cretan, this gave rise to a paradox—if he were telling the truth, then he would be a liar. Depending on how one defines a liar, the paradox is resolvable; he could have been a habitual liar who was telling the truth in this one instance. However, a stronger version of the paradox, known as the Liar paradox—“this sentence is false”—is not resolvable in conventional logic systems.

Indeed, the circular loop that the sentence induces—if it is false, it must be true, and if true, false—has been used more than once in science-fiction movies to cause marauding computers to lose their sanity and explode. But in a new paper, Kostis Vezerides of the American College of Thessaloniki, and Athanasios Kehagias of the Aristotle University of Thessaloniki, in Greece, show that, in almost all cases, paradoxes such as the Liar are resolvable with the use of “fuzzy logic”.

Traditionally, logicians have made a stark distinction between truthhood and falsity. A statement was considered to be either true (given a truth value of one) or false (a value of zero). In the 1960s, Lotfi Zadeh of the University of California at Berkeley came up with the catchy innovation of “fuzzy logic”. In this system, things could be sort-of true, or only partially false. A “truth value” of 0.5 meant that a statement was half-true, and so forth.

In 1979, Dr Zadeh was the first to apply fuzzy logic to self-referential sentences, which can give rise to paradoxes like the ones above. (Not all self-referential sentences are paradoxical—consider “this sentence is true”.) He reasoned that the Liar sentence is exactly half-true. But more complicated self-referential paradoxes are trickier to resolve. One example is the “inconsistent dualist”, which can be thought of as a pair of brothers, one of whom asserts the other is lying, while the other says his brother is telling the truth.

Earlier work had shown how assigning fuzzy values to self-referential sentences could give rise to mathematical chaos. This is because the systems of equations that must be solved to determine the truth-values are often “non-linear”—so attempts to find a solution can rarely be found in the general case, but must be found numerically, closing in on the answer through several iterations of trial and error.

Dr Kehagias and Mr Vezerides, though, set out to find consistent solutions to fuzzy truth equations without chaotic oscillations. The first part of their insight is simple. Using an existing result from calculus called Brower's Fixed-Point Theorem, they proved that at least one solution could be found. They then tried several different numerical algorithms for finding that solution. The simplest is an extension of an idea that Isaac Newton himself had, which uses approximations to the non-linear equations to find their solutions. The method that seems to work best is borrowed from “control theory”, the science of how to operate complicated systems (such as aircraft or chemical plants).

For the comparatively simple case of the Liar, these methods all agree with Dr Zadeh's proof that the sentence is exactly half-true. The two brothers of the inconsistent dualist are also each telling exactly a half-truth. Indeed, the pair show that any set of self-referential sentences that assert complete truth or falsity about one another are exactly half-true. (Though other solutions are possible as well.) Other fractional truth-values arise when the sentences themselves make fuzzy assertions.

Dr Kehagias suggests two directions for further research. The first is to examine the various mathematical algorithms of fuzzy logic from the point of view of psychological authenticity. Since there

might be more than one logically consistent solution to a problem, the idea would be to enable a computer to arrive at the same truth value that a human would, by reasoning in a similar fashion. The second possibility is to devise a form of logic that is in between “fuzzy” logic and normal, true-or-false binary logic. Rather than the infinite choices of fuzzy logic, or the two in binary logic, this would have options for false, true, sort of true, sort of false, and exactly half-way. Epimenides the Cretan would surely have approved, or disapproved—or, most likely, something in between.

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**Naming the villains**

# France's autumn blues

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**Zut alors, even Britain is ahead**

FRANCE is gripped by an outbreak of introspective morosity. Since the start of September, known in French publishing as *la rentrée littéraire*, two bestselling books have prompted an outpouring of "declinism". One title in particular, "La France qui Tombe" ("France is falling over"), a tirade against its failings, has provoked a debate about whether France is indeed in terminal decline.

Nicolas Baverez reads like a man in a rage. A conspiracy of interests, he argues, between France's political class, its bureaucrats and its union leaders is working to defend a state-heavy economic model that has long outlived its usefulness. A system that served France well in the past, in an era of big infrastructure and industrial projects, has never been overhauled in ways that could have helped the country to adapt to the changing world economy. In brief, job-creating enterprise has been suffocated: too many bureaucrats, enforcing too many rules, imposing too many taxes. The result, as he points out, is that the French, whose GDP was 25% higher than Britain's during the 1970s, have been impoverished: today, it is 9% lower, and the French rank only 19th in the OECD wealth-per-head table.

The author's catalogue of complaints is relentless. He seethes at the "autism" of the political class, the "atomisation of French society", the "spread of social nihilism", the "anaemia" of French democracy. In foreign policy, he argues, the French have piled error upon error. They have concealed the deterioration of French military capacity, misread the consequences of the fall of the Berlin Wall, such as the rise of the central and eastern European democracies, and clung to a sense of global importance long diminished.

La France qui Tombe
By Nicolas Baverez

*Editions Perrin; 136 pages; euro12.50*

Buy it at Amazon.fr

Adieu à la France qui s'en va
By Jean-Marie Rouart

*Grasset; 280 pages; euro18*

Buy it at Amazon.fr

These failures were crystallised in President Jacques Chirac's stubborn opposition to the American-led war in Iraq. The initial position was legitimate, Mr Baverez argues, but the manner in which it was carried through ended in ridicule. "France knows what it does not want—the hegemony of the United States in the democratic world, the leadership of the United Kingdom in Europe—but does not know what it wants," he writes.

This paralysis exists because it suits the trio of political, bureaucratic and union interests to keep the system the way it is. No government has found the courage to persuade France of the need for shock-therapy. Instead, successive leaders, in particular François Mitterrand and Mr Chirac, have sought scapegoats—globalisation, immigration, the reunification of Germany—for French difficulties, instead of confronting them honestly. Worse, they have defended France's refusal to change in the name of a "French exception". This sham is dangerous, Mr Baverez says, because the deception of the electorate feeds the populist, anti-establishment message of the far-right National Front.

Perhaps Mr Baverez's greatest rage is levelled at the missed opportunity presented by the 2002 presidential election. Such was the support for Jean-Marie Le Pen, the National Front leader, that he evicted the Socialist candidate, Lionel Jospin, in the first round. The electorate, argues Mr Baverez, was crying out for change. Instead, they got half-hearted "mini-reforms". It is nonsense, Mr Baverez writes, to say that France is unreformable: "It is the government which is incapable of conceiving and implementing reform."

Most of what Mr Baverez has to say makes good sense. That it has touched such a raw nerve suggests that many French people think so too. His main shortcoming is that, in his haste to criticise, he is careless about facts that do not suit. So the unusually high French savings rate, for instance, is not an opportunity for the economy but evidence of French fear for the future. He makes scant mention of the many French companies that have been privatised over the past decade, nor of the world-ranking private companies—AXA, Carrefour, L'Oréal, Danône, Michelin—that France has produced. He certainly makes no effort to explain how a system he deplores has enabled such companies to prosper. Given the electric shock that this book has given the French establishment, however, perhaps such failings should be forgiven.

Where Mr Baverez is clinical in his analysis and unsentimental in style, Jean-Marie Rouart, on the other hand, transports the reader into an altogether different world of nostalgia for a France long-gone. His is a beautifully written lament for a different age, and idea, of France. In semi-autobiographical style, he travels into his childhood and into history—from Joan of Arc to De Gaulle—in search of the people who gave France its sense of self, its soul. It is a France of personal honour and of the senses: the "sour smell of dung rotting in the sun", church bells ringing, shutters closed against the heat.

In a journey that begins with the author as a child attending the burial of a courageous French commander, killed in battle in Indo-China, three themes recur. The first is the decline of honour, which the dead commander embodies in its purest military sense. The second is the decline of the French language, which has lost the importance it had at the height of great French literature. The third is a loss of spirituality. In an era dominated by power, profit and loss, the author marvels at the nobility of spirit of a community of Cistercian Trappist monks in Algeria, seven of whom ended up dead at the hands of Islamic extremists.

In style as well as substance, these two books could not be more different. In their common sense of French decline, however, which has a long tradition in French writing, they share a bleakness that has struck a chord in contemporary France.

La France qui Tombe.
By Nicolas Baverez.
*Editions Perrin; 136 pages; euro12.50*

Adieu à la France qui s'en va.
By Jean-Marie Rouart.
*Grasset; 280 pages; euro18*

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About sponsorship

China and America

# Does China awake?

Oct 2nd 2003
From The Economist print edition

NAPOLEON once remarked that when China wakes, it will astonish the world. Two hundred years later, the world remains at best mildly surprised. (Napoleon would probably say that the dragon is still half-asleep.) But that has done little to stem the flood of ink expended on this most perennially disappointing, but still fascinating, of countries. Two new books stake out worthy claims for space on the sinophile's bookshelf.

Robert Suettinger's is the better volume. The head of America's National Security Council's Asian section during part of the Clinton presidency, he was well placed to witness the way that Sino-American relations were conducted at a delicate period, which included the mini-crisis caused by China's firing of missiles towards Taiwan in 1996, and the deeply controversial state visit of 1998. Over the whole period bulked the enormous shadow of the Tiananmen massacre.

The book is full of delightful nuggets, such as the story of the deliberately dreadful dinner laid on for a visiting Chinese envoy by the angry Americans in 1996. Its weakness is that it is written very much from an American perspective, though Mr Suettinger's central judgment—that there is no inevitability about conflict between America and China—is surely right. And he is probably right too when he enumerates the long list of tensions that remain, and laments the lack of progress in dealing with them.

Ross Terrill's book is rather more ambitious, beginning as it does with the Qin dynasty (221-206BC) and ending with a series of possible scenarios for China's political evolution over the next 20 years or so, ranging from fascism to liberal democracy. The new Chinese empire of the title has, according to Mr Terrill, more in common than it would care to admit with the past, all the way back to the first emperor of all, Qin Shihuang.

The use of the word “empire” is an important one. With the demise of the Soviet Union, Mr Terrill says, China is now the only empire left on earth, if the term empire is defined as a multicultural country held together essentially by force. Ruling over a vast land, one third of which (principally Tibet and Xinjiang) is inhabited mainly by non-Chinese people, the Chinese Communist Party, though professing to sweep away 2,500 years of monarchy, has instituted an imperial dynasty of its own. Perhaps this should have surprised no one who saw how Mao proclaimed the People's Republic from Tiananmen, the ceremonial entrance to the Forbidden City, before making his home inside it.

More controversially, Mr Terrill dismisses this imperial China as a dysfunctional state: a judgment that may stem too instinctively from loyalty to his own American system, and which leads him to assert that China's science and technology, developed under the yoke of “Communist repression”, will never prove very impressive. In fact, much though one might disagree with its appalling human rights abuses, China's polity today is functional, and its technological prowess arguably greater than that of any other developing country.

Mr Terrill does a good job of explaining the all-encompassing nature of Communist rule. He is less successful when he discusses how far personal freedoms have advanced in the past ten years and how pluralism has started to gain a toehold in the shape of a more independent press and the flowering of

Beyond Tiananmen: The Politics of U.S.-China Relations 1989-2000
By Robert L. Suettinger

*Brookings Institution Press; 556 pages; $39.95 and £29.95*

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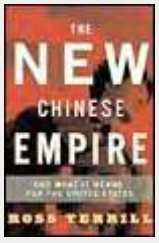
The New Chinese Empire and What it Means for the United States
By Ross Terrill




*Basic Books; 384 pages; $30 and $22.50*

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citizens' groups, despite the limitations of both. Yet, for all those criticisms, this is an interesting read, especially in its historical sections, though it could have done with less sociological jargon and fewer annoying italics.

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About sponsorship

Chechnya

# Where life is no party

Oct 2nd 2003
From The Economist print edition

WRIT small or writ large, Russia's miserable lack of respect for human life leaps off the pages of these books. Both are works of great but disorganised talent. Anna Politkovskaya, Russia's best-known independent reporter, is an indefatigable chronicler of the single nastiest side of modern Russia: the rapes, tortures, looting and killing of the unwon war in Chechnya. David Satter, one of the finest and most energetic foreign reporters in the Soviet era, sketches a bigger but equally dark picture—the capture of Russia's infant democracy by the lawless demons spawned in the country's totalitarian past.

Ms Politkovskaya's book risks leaving the foreign reader not just aghast, but stunned and somewhat confused. Closely based on her reporting from Chechnya for the trashy but feisty *Novaya Gazeta*, a more-or-less independent Moscow newspaper, it skips harrowingly from year to year and place to place. The arch-villains are the Russian death squads, venal and brutal, and the complacent, lying politicians and generals who profit from the illegal trade in booty, oil and captives.

Her heroes are not the Chechen resistance—a gangsterish and ill-led lot—but the long-suffering civilian population, whose natural grit and solidarity has gradually dissolved under the relentless brutality of daily life. “The war hasn't just damaged the Chechen land—it has also scarred the people's souls,” she writes.

Dotted among the dismal and vivid cameos of life and death there are interesting nuggets about the politics of Chechnya. No negotiated settlement is in sight while the status quo is so lucrative. The Chechen leadership, such as it is, hangs on grimly, hoping that the war's unpopularity at home may eventually push Russia towards compromise.

Mr Satter's book is principally a series of well-told and very depressing extended essays about different aspects of official and private callousness and crime in modern Russia. His thesis, broadly speaking, is that the country is utterly in hock to criminals for whom fellow-citizens' lives are worth little more than the cost of a bullet.

As with Ms Politkovskaya's book, the weakness is its structure. Like Mr Satter's earlier book, the brilliant but flawed “Age of Delirium”, this reads more like the randomly divulged contents of a well-kept notebook, than a considered work of contemporary history. After cantering through swindles, murders, bombs and the murky intrigues of Kremlin politics, the reader suddenly, on page 201, reaches an interesting historical-philosophical digression, on the lack of ethical transcendence in Russian intellectual history. This, Mr Satter argues, explains why the reformers in the 1990s were so blind to moral considerations, and so willing to put self-interest ahead of any idea of the common good. Tantalisingly, this train of thought disappears after two pages, only to pop up in the final paragraphs of the book. Convincingly elaborated, it might explain a lot.

A Small Corner of Hell: Dispatches from Chechnya.
By Anna Politkovskaya.
*University of Chicago Press; 232 pages; $25 and £17.50*

Darkness at Dawn: The Rise of the Russian Criminal State.
By David Satter.

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**Biography**

# Into the green hills

Oct 2nd 2003
From The Economist print edition

ERNEST HEMINGWAY made only a couple of short trips to Africa, the first in 1933-34 and the second two decades later, but the continent brought forth two of his greatest pieces of fiction.

If “The Snows of Kilimanjaro”—inspired by the story of the mysterious leopard found dead, encased in ice, far above the snowline of Africa's highest mountain—allowed Hemingway to use words as paint and give rein to his immense talent for writing about place, it was man's deepest fears and sense of cowardice that he explored in “The Short Happy Life of Francis Macomber”.

A young American couple are accompanied on their first African safari by a professional hunter. Lying at night in his tent, next to his wife who does not love him, the husband hears a lion roar, but he has “no one to tell he was afraid, nor to be afraid with him”. Within days he is dead, of a gunshot wound to the head.

Sir Christopher Ondaatje, too, knows about fear and the atavistic draw of a landscape. A former Olympic bobsledder, who gave up playing the markets just before the 1987 crash to go trekking, Sir Christopher has here retraced Hemingway's African safaris in an effort to tease out the inspiration that the continent offered his writing.

By carefully researching Hemingway's published and unpublished work, as well as the journals kept by his wives, and by consolidating both of Hemingway's African journeys into one, Sir Christopher also seeks to understand how it was that the alpha male of the 1933-34 safari could have gone on to produce the incoherent “True at First Light” that emerged from a second trip that so nearly cost Hemingway his life.

Beautifully illustrated and eminently readable, “Hemingway in Africa” is neither judgmental about the laureate's failings nor sycophantic; rather it combines a deep love for Hemingway's finest writing with a genuine feel for the continent that inspired him.

Hemingway in Africa: The Last Safari.
By Christopher Ondaatje.
*HarperCollins; 237 pages; $30 and £24.95*

Hemingway in Africa: The Last Safari
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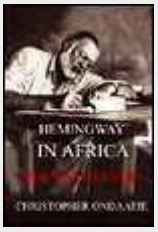


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**Biography**

# A problem marriage

Oct 2nd 2003
From The Economist print edition

THE title of Caroline Moorehead's excellent biography of Martha Gellhorn—who was born in 1908 and died in 1998—is apt. Gellhorn's life as a journalist took her to many of the 20th-century's central locations, beginning in Spain in the 1930s and ending in the 1990s when, almost blind and partially crippled by persistent back problems, she set off to Brazil to write about the plight of street orphans.

Gellhorn was born in St Louis, Missouri, to a doctor father and a suffragette mother. They raised her to confidence and campaigning, instilling in her a ferocious sense of right and wrong, of her own responsibility to bear witness to those wrongs and a huge intolerance for people who turned the other cheek. In 1935 she took a job writing about how the Depression was affecting America's poor for the Federal Emergency Relief Administration. Her reports showed all the hallmarks of her later journalism: first-person accounts of poverty spiked with Gellhorn's own personal sense of outrage.

If Gellhorn became well known both as a journalist and a writer of fiction, she became famous for being one of Ernest Hemingway's wives. References to their lives together irritated and angered her. Their marriage, which began in the 1930s, lasted through the Spanish civil war, an idyllic period in Cuba where Hemingway wrote “For Whom the Bell Tolls” and dedicated it to Gellhorn, and finally to Europe where they both covered the fighting for rival American publications. It ended in extreme bitterness.

Gellhorn: A Twentieth-Century Life
By Caroline Moorehead

*Henry Holt; 480 pages; $27.50. Chatto and Windus; £20*

Buy it at
Amazon.com
Amazon.co.uk

Hemingway pulled a fast one on his wife when he offered to cover the evacuation of Dunkirk for *Collier's*, the magazine Gellhorn had long been working for. Deprived of any accreditation of her own, Gellhorn stowed away on a hospital ship leaving Britain for France by locking herself in the lavatory and staying put until the ship was at sea. Once in France, she went ashore to help carry aboard the wounded. Hemingway, on the contrary, sailed with official troops. According to Gellhorn he didn't even get his feet wet, though from his dispatches the reader might be fooled into thinking he had behaved like a hero.

Thus, to write successfully about Gellhorn while she was still alive would have been an uphill battle (though people did try). Ms Moorehead is excellent at capturing Gellhorn's capriciousness: on the one hand the most staunch and loyal friend, on the other, someone capable of petty meanness, selfishness and vanity. Friends could be arbitrarily banished, and her son Sandy, adopted by Martha in Italy after the war, had an unenviable upbringing. Gellhorn saw him as an experiment, not as a life-long commitment; outraged at one time that Sandy had grown fat (she watched her own weight keenly) Gellhorn disinherited him until he had slimmed down.

Her almost pathological reverence for the truth made her a remarkable journalist. Gellhorn listened to and recorded the voices of the ordinary people innocently caught up in conflicts. She hated bureaucracy, never went to press conferences and had a nose for the duplicity of spin long before the expression became widespread. Her fiction writing, though “The Weather in Africa” is well loved, was never judged to be as good as her journalism. Fiction has to bend the truth and this was never Gellhorn's forte.

She was lonely for much of her life. Her three marriages failed. She once described sex as “like a sandwich, Darling. Something you must give them in order to get back to the real business of drinking and talking.” Though dogged by ill-health, her final years were some of her happiest. Surrounded by a group of much younger people who admired and loved her, she would hold court from her sixth-floor London flat. Often they stayed till the small hours, proud that she called them the “chaps”.

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**Ned Rorem**

# Celebrating a rebel

Oct 2nd 2003
From The Economist print edition

**Protest against the “serial killers”**

IN 1989, Ned Rorem wrote, “Nobody sings my songs anymore...season after season passes with nary a mention.” Now he is regarded as one of the most important contemporary masters of art song. This month Mr Rorem celebrates his 80th birthday, though he tells reporters he still feels like a teenager, and orchestras and soloists in America and Europe are marking the occasion with concerts.

The works they are celebrating will include not only his songs—there are more than 300—but his orchestral and chamber works as well, among them his violin concerto, composed in 1984. A recording by Leonard Bernstein, with Gidon Kremer as soloist, was a key factor in the reassessment of his work.

The previous apathy towards Mr Rorem was due to what he calls the “serial killers”, the fashion for atonal or serial music. He never embraced the 12-tone or any other principle of manipulating composition. His music is deceptively straightforward, often concealing within a conventional form what would have once been considered as abrasively modern.

He gained fame as a writer too. “The Paris Diary of Ned Rorem”, published in 1966, described his adventures as a young man, rebellious, swaggering, drunken and promiscuous. He seems to have known every celebrity in Paris, among them Picasso, Cocteau, Jean Genet and Simone de Beauvoir. His French-inspired compositions include “Picnic on the Marne” (a suite for saxophone and piano), “Letter from Paris” (a choral piece based on the words of Janet Flanner, then Paris correspondent of the *New Yorker*), and, one of his often performed songs, “Early in the Morning”, after a poem by Robert Hillyer.

Back in America he metamorphosed into a sober sage. “Does one get better, or even different?” he wrote. “One repeats oneself in different shapes, large and small and tight and loose for ever.” Students have the pleasure of sharing his thoughts on music and literature at the Curtis Institute in Philadelphia, where he has been professor of music since 1980. He was made president of the American Academy of Arts and Letters in 2000. As he enters his ninth decade, he remains busy. Mr Rorem's own celebration of his birthday will be to start work on an opera based on Thornton Wilder's play “Our Town”.

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New fiction

# Revolution in Chelsea

Oct 2nd 2003
From The Economist print edition

SOMETHING strange is happening in Chelsea Marina, a posh gated community in south-west London and the setting of J.G. Ballard's wonderfully warped new novel. The residents—prosperous, Volvo-driving, school-fee-paying middle-class pillars of society—are starting to go wild in the streets. First Broadcasting House, the home of the BBC, is stormed. Then the National Film Theatre is set ablaze and Tate Modern firebombed. Before long, retired majors are pelting policemen with Molotov cocktails fashioned from bottles of vintage Burgundy and stoppered with regimental ties.

What has got into these people? The answer is Richard Gould, an unhinged paediatrician-turned-revolutionary who believes that only the most pointless acts can "challenge the universe at its own game", that violence "should always be gratuitous" and that "no serious revolution should ever achieve its aims".

Gould's newest disciple is David Markham, a psychologist whose first wife has recently died following an explosion at Heathrow airport. It is Markham's search for her killers which leads him from his cosy life in St John's Wood across town to Chelsea Marina. Any qualms Markham might have had about fraternising with the people who may have murdered his former wife are soon forgotten as he becomes fascinated by, if not quite converted to, Gould's religion of pointless violence. The protest of the Chelsea Mariners, reckons Gould, is just a symptom of more widespread middle-class unrest. "It's part of a much larger movement, a current running through all our lives, though most people don't realise it," he says. "There's a deep need for meaningless action, the more violent the better."

Mr Ballard is not well known for his sense of humour, yet there is a blackly comic side to "Millennium People", beautifully showcased in a scene where rampaging animal-rights activists try to break up a cat show. The novel, like its bestselling predecessors "Cocaine Nights" and "Super-Cannes", is written with Mr Ballard's customary panache, and its potent mix of sex, violence and radicalism will keep his fans happy. "Millennium People" is at once deadly serious and slightly ridiculous—and somehow all the more unsettling for it.

Millennium People.
By J.G.Ballard.
*Flamingo; 294 pages; £16.99*

Millennium People
By J.G.Ballard

*Flamingo; 294 pages; £16.99*

Buy it at
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About sponsorship

# Edward Said

Oct 2nd 2003
From The Economist print edition

**Edward Said, eloquent spokesman for Palestine, died on September 25th, aged 67**

The Independent

"YOU'RE treated like a diplomat of terrorism, with a place at the table," remarked Edward Said when Salman Rushdie asked him (in a conversation reproduced in "The Politics of Dispossession", published in 1994) what it was like for him, the distinguished professor of English and comparative literature at Columbia University, to be Palestine's voice in the United States. Mr Said repudiated terrorism, in all its forms, but was a passionate, eloquent and persistent advocate for justice for the dispossessed Palestinians, struggling to make his case to people whose sympathies are largely given over to the nation, Israel, that carried out the dispossessing. He understood that sympathy, and the sea of old guilt that lies beneath it. But, as he wrote wryly, and with unusual understatement given the snide character-assassination he constantly suffered, "To be the victim of a victim does present quite unusual difficulties."

Literature and politics came together in "Orientalism", Mr Said's best known and most influential book, published in 1978. Entwining political and cultural imperialism, the work argues that western writers and academics have misrepresented, and still misrepresent, the Islamic world in a manner that has eased the way for the West to dominate the East. All this, naturally, was deeply unpopular with the formidable scholars he denigrated. But "Orientalism", translated into dozens of languages, became a foundation text for a great boom in post-colonial studies.

Not always with beneficial results. Students from the Middle East, reading his words, have seized the chance of finding yet another excuse to pile their misfortunes on to the broad shoulders of the imperialist West. But Mr Said himself was a punishing critic of the sordid, totalitarian Arab regimes that litter the region. "It is the role of the Arab intellectual", he wrote, "to articulate and defend the principles of liberation and democracy at all costs."

Among sordid regimes, he came to class Yasser Arafat's Palestinian government. In the 1980s, Mr Said, a member of the Palestine National Council at the time, was influential in urging Mr Arafat towards the two-state solution in which Palestine and Israel could coexist. But he grew disillusioned with a leader who tolerated corruption and ineptitude, marginalised some of the finest Palestinian minds, and who, in 1993, signed up to an agreement that Mr Said saw as certain disaster for the Palestinians, in that it offered the Israelis security while they colonised more land.

As the Oslo process dribbled wretchedly on, he kept up a barrage of pointed, hard-to-answer abuse. Sometimes it was fair to ask what alternative he was offering. But, in the end, his prophecies of doom came to pass. By then, perhaps despairing of a decent splitting of the land, Mr Said had taken to musing, in the last years of the leukaemia that took 12 years to kill him, on a single democratic state in which Jews and Arabs could live peaceably together.

He also turned to music, his great love (he was a gifted pianist). And, in contrast to the acrimonious conjunction of literature and politics, music and politics came happily together when he and his close friend, Daniel Barenboim, a renowned Israeli conductor with no time for political grandstanding, established a youth orchestra of Arabs and Israelis, and Mr Barenboim held master classes in the occupied West Bank.

A legion of friends notwithstanding, Mr Said always saw himself as an outsider, drawn to minorities and losers. He had, wrote Hanan Ashrawi, one of those fine Palestinians who has been pushed to one side by

the Arafat regime, “a gentle identification with the oppressed, and an intimidating rage against the oppressor.”

Born in West Jerusalem, in a district that since 1948 has been part of Israel, he was brought up in Cairo and in the United States. He inherited an American passport from his father's service with the American army in the first world war, and was christened Edward in 1935 after the British prince of Wales who later, as Edward VIII, abdicated for love of an American. As a Christian-Palestinian he felt alienated in colonial Egypt; as an Arab he was an outsider in America. Gradually, though not fully until after the 1967 war in which Israel occupied what remained of Palestine, he began to feel the “desolation of being without a country or place to return to.”

## A scrapper, too

And this remained with him, as he began his long fight for justice for his people, a people who, as he wrote, have been “excluded, denied the right to have a history of their own”. He was a humanist, which he defined as using “one's mind historically and rationally for the purpose of reflective understanding”. He was also, from time to time, a scrapper, letting loose blasts of over-the-top polemic.

In the end, nothing worked. The current American administration sometimes says reasonable things about Palestine, though usually in made-in-Israel terms, but it has never followed them through. A couple of months ago, Edward Said wrote sadly in the *Los Angeles Times*: “We are in for many more years of turmoil and misery in the Middle East, where one of the main problems is, to put it as plainly as possible, American power. What America refuses to see clearly, it can hardly hope to remedy.”

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# Overview

Oct 2nd 2003
From The Economist print edition

**Consumer confidence** in America suffered a surprise blow. The Conference Board's index of confidence fell in September to 76.8 from 81.3 in August. Consumers' impressions of current conditions as well as their expectations for the future became gloomier. The manufacturing outlook is brighter: the ISM purchasing managers' survey in September showed continuing growth.

**American economic growth** in the second quarter was revised up for the second time. The economy grew by 3.3% at an annual rate, up from 3.1% in the previous estimate.

The European Commission's **euro-area** economic-sentiment index rose in September to its highest level this year. Industrial confidence picked up slightly, while consumer confidence was unchanged from August.

**Australia's** industrial production grew by 1.3% in the year to the second quarter.

**Britain's** GDP grew by twice as much as originally estimated in the second quarter. Growth was revised up from 0.3% to 0.6%, for a 12-month increase of 2.0%, owing to more construction having been found.

**Japan's** Tankan survey of business confidence rose to its highest level in almost three years, matching financial-market expectations. Unemployment fell to a two-year low in August of 5.1%. Industrial production fell by 0.5% in August.

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# Output, demand and jobs

Oct 2nd 2003
From The Economist print edition

% change on year ago

| | GDP | | The Economist poll GDP forecasts | | Industrial production | | Retail sales (volume) | | Unemployment % rate | |
|---|---|---|---|---|---|---|---|---|---|---|
| | latest | qtr* | 2003 | 2004 | latest | | latest | | latest | year ago |
| **Australia** | + 2.0 Q2 | + 0.5 | + 2.8 | + 3.6 | + 1.3 Q2 | | + 3.6 Q2 | | 5.8 Aug | 6.2 |
| **Austria** | + 1.0 Q1 | + 0.7 | + 0.6 | + 1.7 | − 1.9 Dec | | − 0.5 Jun | | 4.5 Jul | 4.3 |
| **Belgium** | + 0.8 Q2 | − 0.4 | + 0.8 | + 1.8 | + 1.6 Jul | | + 0.9 Jul | | 13.3 Aug† | 12.0 |
| **Britain** | + 2.0 Q2 | + 2.4 | + 1.7 | + 2.5 | − 0.5 Jul | | + 3.8 Aug | | 5.1 Jul†† | 5.2 |
| **Canada** | + 1.6 Q2 | − 0.3 | + 2.0 | + 3.0 | + 0.5 Jun | | + 2.3 Jun | | 8.0 Aug | 7.5 |
| **Denmark** | − 0.8 Q2 | − 1.8 | + 1.0 | + 2.1 | + 1.6 Jul | | + 2.2 Jun | | 6.0 Jul | 5.1 |
| **France** | − 0.3 Q2 | − 1.3 | + 0.4 | + 1.8 | − 1.1 Jul | | − 2.2 May | | 9.6 Aug | 9.1 |
| **Germany** | − 0.2 Q2 | − 0.2 | nil | + 1.5 | + 1.4 Jul | | − 4.9 Aug‡ | | 10.6 Aug§ | 9.8 |
| **Italy** | + 0.3 Q2 | − 0.3 | + 0.4 | + 1.6 | + 0.4 Jul | | − 2.1 Jun | | 8.7 Jul | 9.0 |
| **Japan** | + 3.0 Q2 | + 3.9 | + 2.5 | + 1.9 | − 1.2 Aug | | − 2.6 Jul | | 5.1 Aug | 5.5 |
| **Netherlands** | − 1.2 Q2 | − 2.4 | − 0.5 | + 1.3 | − 3.2 Jun | | − 1.1 Apr | | 5.3 Aug** | 4.2 |
| **Spain** | + 2.3 Q2 | + 2.7 | + 2.1 | + 2.8 | + 1.7 Jul | | + 3.6 Jul | | 11.4 Jul | 11.3 |
| **Sweden** | + 1.3 Q2 | + 1.2 | + 1.5 | + 2.3 | + 2.5 Jul | | + 5.0 Jul | | 5.4 Aug† | 4.1 |
| **Switzerland** | − 1.0 Q2 | − 1.2 | − 0.4 | + 1.3 | + 0.9 Q1 | | + 1.5 Jul | | 3.6 Aug† | 2.4 |
| **United States** | + 2.5 Q2 | + 3.3 | + 2.6 | + 3.7 | − 1.0 Aug | | + 6.3 Jul | | 6.1 Aug | 5.8 |
| **Euro area** | + 0.2 Q2 | − 0.3 | + 0.5 | + 1.8 | − 0.3 Jul | | + 0.7 Jun | | 8.8 Aug | 8.4 |
| **MORE COUNTRIES** | Data for the countries below are not provided in printed editions of *The Economist* | | | | | | | | | |
| **Finland** | + 0.8 Q2 | + 2.4 | na | na | + 1.9 Aug | | + 2.7 Jun | | 7.7 Aug† | 8.1 |
| **Greece** | + 4.5 Q2 | + 0.4 | na | na | + 2.1 Jul | | na | | na | na |
| **Iceland** | + 2.7 Q2 | na | na | na | − 0.3 2002 | | na | | 2.9 Aug† | 2.2 |
| **Ireland** | + 0.5 Q1 | na | na | na | +10.7 Jul | | + 2.1 Jul | | 4.5 Aug | 4.3 |
| **Luxembourg** | + 1.1 2002 | na | na | na | − 3.6 Jun | | − 1.6 Mar | | 3.7 Jul | 2.8 |
| **New Zealand** | + 2.0 Q2 | − 0.5 | na | na | + 4.2 Q1 | | + 5.1 Q2 | | 4.7 Q2 | 5.2 |
| **Norway** | − 2.0 Q2 | − 0.6 | na | na | − 2.8 Jul | | + 6.5 Aug | | 4.7 Q2 | 4.0 |
| **Portugal** | − 2.3 Q2 | + 0.5 | na | na | − 0.8 Jul | | − 1.4 Aug | | 6.2 Q2† | 4.5 |

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡New series. ††May-Jul; claimant count rate 3.1% in Aug. §EU harmonised rate 9.4% in Aug. **Jun-Aug.

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# Prices and wages

Oct 2nd 2003
From The Economist print edition

% change on year ago

| | Consumer prices | | The Economist poll consumer prices forecast | | Producer prices | | Wages/earnings | |
|---|---|---|---|---|---|---|---|---|
| | latest | year ago | 2003 | 2004 | latest | year ago | latest | year ago |
| Australia | + 2.7 Q2 | + 2.8 | + 2.8 | + 2.4 | + 0.2 Q2 | – 1.1 | + 5.5 Q2 | + 3.7 |
| Austria | + 1.1 Aug | + 1.9 | + 1.3 | + 1.2 | + 1.3 Aug | – 0.6 | + 2.1 Jul | + 2.4 |
| Belgium | + 1.8 Sep | + 1.3 | + 1.4 | + 1.3 | – 1.4 Aug | + 0.8 | + 1.7 Q2 | + 2.6 |
| Britain | + 2.9 Aug | + 1.4 | + 2.7 | + 2.3 | + 1.6 Aug | + 0.4 | + 3.4 Jul | + 3.9 |
| Canada | + 2.0 Aug | + 2.6 | + 2.7 | + 1.9 | – 1.6 Jul | – 0.2 | + 3.8 Jun | + 2.9 |
| Denmark | + 1.7 Aug | + 2.3 | + 2.2 | + 1.8 | – 0.3 Aug | – 0.4 | + 3.8 Q2 | + 3.7 |
| France | + 1.9 Aug | + 1.8 | + 2.0 | + 1.4 | + 0.5 Aug | – 0.1 | + 2.7 Q2 | + 3.9 |
| Germany | + 1.1 Sep | + 1.1 | + 1.0 | + 0.7 | + 0.8 Aug | – 0.5 | + 2.2 Jul | + 2.3 |
| Italy | + 2.8 Sep | + 2.6 | + 2.7 | + 2.0 | + 1.3 Aug | + 0.6 | + 2.6 Aug | + 2.3 |
| Japan | – 0.3 Aug | – 0.9 | – 0.3 | – 0.2 | – 0.6 Aug | – 2.0 | – 0.2 Aug | – 2.7 |
| Netherlands | + 2.1 Aug | + 3.3 | + 2.3 | + 1.7 | + 2.6 Aug | + 0.4 | + 2.0 Jul | + 3.4 |
| Spain | + 3.0 Aug | + 3.6 | + 3.0 | + 2.5 | + 1.1 Aug | + 0.7 | + 4.9 Q1 | + 4.0 |
| Sweden | + 1.7 Aug | + 2.0 | + 2.2 | + 1.7 | – 1.7 Aug | – 0.3 | + 3.3 Jun | + 3.1 |
| Switzerland | + 0.5 Sep | + 0.5 | + 0.6 | + 0.6 | – 0.3 Aug | – 1.4 | + 1.8 2002 | + 2.5 |
| United States | + 2.2 Aug | + 1.8 | + 2.2 | + 1.4 | + 3.4 Aug | – 1.5 | + 2.9 Aug | + 3.0 |
| Euro area | + 2.1 Sep | + 2.1 | + 2.0 | + 1.5 | + 1.3 Jul | – 0.3 | + 3.0 Q1 | + 3.3 |
| MORE COUNTRIES | Data for the countries below are not provided in printed editions of *The Economist* | | | | | | | |
| Finland | + 0.6 Aug | + 1.4 | na | na | – 0.1 Aug | – 1.8 | + 4.3 Q2 | + 3.9 |
| Greece | + 3.3 Aug | + 3.5 | na | na | + 2.2 Aug | + 2.1 | na | na |
| Iceland | + 2.2 Sep | + 3.1 | na | na | + 3.6 Sep | + 6.1 | + 5.7 Aug | + 6.0 |
| Ireland | + 3.2 Aug | + 4.5 | na | na | – 7.8 Aug | – 2.2 | + 7.1 Q1 | + 6.9 |
| Luxembourg | + 2.0 Aug | + 1.8 | na | na | + 0.6 Jul | – 0.9 | nil Jun | – 0.6 |
| New Zealand | + 1.5 Q2 | + 2.8 | na | na | – 2.0 Q2 | + 1.5 | + 2.3 Q2 | + 2.1 |
| Norway | + 2.1 Aug | + 1.4 | na | na | + 6.1 Aug | – 8.6 | + 5.4 Q2 | + 4.9 |
| Portugal | + 2.8 Aug | + 3.7 | na | na | nil Aug | + 0.2 | nil Jun | + 0.5 |

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# Economic forecasts

Oct 2nd 2003
From The Economist print edition

**The Economist poll of forecasters, October averages** (previous month's, if changed)

| | Real GDP, % change Low/high range | | Real GDP, % change average | | Consumer prices % increase | | Current account % of GDP | |
|---|---|---|---|---|---|---|---|---|
| | 2003 | 2004 | 2003 | 2004 | 2003 | 2004 | 2003 | 2004 |
| **Australia** | 2.4/3.5 | 2.9/4.9 | 2.8 | 3.6 (3.5) | 2.8 (2.7) | 2.4 (2.3) | −5.6(−5.1) | −5.0 (−4.6) |
| **Austria** | 0.4/1.1 | 1.2/2.2 | 0.6 (0.5) | 1.7 (1.4) | 1.3 | 1.2 (1.1) | 0.2 | nil (0.1) |
| **Belgium** | 0.4/1.3 | 1.3/2.5 | 0.8 (0.7) | 1.8 (1.6) | 1.4 (1.3) | 1.3 (1.1) | 4.6 (4.7) | 4.6 (4.7) |
| **Britain** | 1.4/2.0 | 1.9/3.2 | 1.7 (1.8) | 2.5 (2.4) | 2.7 | 2.3 (2.4) | −1.1 | −1.5 (−1.3) |
| **Canada** | 1.8/2.8 | 2.4/3.7 | 2.0 (2.2) | 3.0 | 2.7 (2.8) | 1.9 | 1.7 | 1.6 |
| **Denmark** | 0.5/1.8 | 1.8/2.5 | 1.0 (1.1) | 2.1 | 2.2 | 1.8 | 2.8 (2.6) | 2.6 (2.4) |
| **France** | 0.2/0.7 | 1.3/2.9 | 0.4 (0.7) | 1.8 (1.9) | 2.0 (1.8) | 1.4 (1.3) | 1.5 (1.4) | 1.5 (1.3) |
| **Germany** | −0.2/0.1 | 0.9/2.1 | nil | 1.5 (1.3) | 1.0 (0.9) | 0.7 (0.6) | 2.0 | 1.9 (1.8) |
| **Italy** | 0.3/0.6 | 0.7/2.4 | 0.4 (0.5) | 1.6 | 2.7 (2.5) | 2.0 (1.9) | −0.8(−0.5) | −0.6 (−0.4) |
| **Japan** | 2.0/3.0 | 0.9/3.1 | 2.5 (1.5) | 1.9 (1.3) | −0.3 (−0.4) | −0.2 (−0.3) | 2.8 (2.6) | 2.9 (2.8) |
| **Netherlands** | −0.7/nil | 0.8/2.8 | −0.5 (−0.2) | 1.3 (1.4) | 2.3 | 1.7 (1.8) | 2.2 | 2.7 (2.4) |
| **Spain** | 1.7/2.4 | 2.2/3.6 | 2.1 (1.9) | 2.8 (2.6) | 3.0 | 2.5 | −2.4 | −2.2 (−2.3) |
| **Sweden** | 0.9/1.8 | 1.8/3.2 | 1.5 | 2.3 (2.2) | 2.2 | 1.7 (1.6) | 4.1 (3.6) | 3.9 (3.4) |
| **Switzerland** | −0.7/0.3 | 0.7/2.2 | −0.4 (−0.1) | 1.3 | 0.6 | 0.6 | 10.6(10.7) | 10.8 (10.6) |
| **United States** | 1.9/2.8 | 2.2/4.5 | 2.6 (2.4) | 3.7 (3.6) | 2.2 | 1.4 (1.3) | −5.3(−5.2) | −5.5 |
| **Euro area** | 0.3/0.6 | 1.3/2.6 | 0.5 | 1.8 (1.7) | 2.0 (1.8) | 1.5 (1.3) | 0.4 (0.6) | 0.5 |

Sources: ABN Amro, Deutsche Bank, Economist Intelligence Unit, Goldman Sachs, HSBC Securities, KBC Bank, Merrill Lynch, J.P. Morgan Chase, Morgan Stanley, Nordea, Decision Economics, BNP Paribas, Royal Bank of Canada, Citigroup, Scotiabank, UBS

Every month *The Economist* calculates the average of a group of forecasters' predictions for economic growth, inflation and current-account balances for 15 countries and for the euro area. The table also shows the highest and lowest projections for growth. The previous month's figures, where different, are shown in brackets. Our panel has again become more optimistic about the outlook for Japan. It has raised its growth forecast for 2003 to 2.5%, the third-highest in our 15 countries, and much higher than the 1.5% it predicted last month. And it expects Japan to grow by 1.9% in 2004, up from 1.3% in September. The panel is forecasting somewhat higher growth in most countries next year, with the United States tipped to expand by 3.7% and the euro area by 1.8%. It has also raised this year's growth forecast for America to 2.6%.

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# Money and interest rates

Oct 2nd 2003
From The Economist print edition

| | Money supply* % change on year ago | | | Interest rates % p.a. (Oct 1st 2003) | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | 3-mth money market | | 2-year | 10-year gov't bonds | | corporate |
| | narrow | broad | | latest | year ago | gov't bonds | latest | year ago | bonds |
| **Australia** | + 7.4 | +12.2 | Aug | 4.86 | 4.92 | 4.79 | 5.37 | 5.46 | 5.93 |
| **Britain** | + 7.9 | + 6.6 | Aug | 3.66 | 3.88 | 3.99 | 4.53 | 4.45 | 5.64 |
| **Canada** | + 9.3 | + 5.9 | Aug | 2.59 | 2.77 | 2.92 | 4.56 | 4.96 | 6.29 |
| **Denmark** | + 7.3 | + 8.9 | Aug | 2.18 | 3.45 | 2.55 | 4.13 | 4.56 | 5.42 |
| **Japan** | + 5.5 | + 2.0 | Aug | 0.01 | 0.01 | 0.17 | 1.40 | 1.13 | 1.49 |
| **Sweden** | + 3.8 | + 5.5 | Aug | 2.70 | 4.01 | 2.99 | 4.46 | 4.86 | 3.56 |
| **Switzerland** | +24.8 | + 9.9 | Aug | 0.24 | 0.75 | -0.38 | 2.50 | 2.57 | 2.86 |
| **United States** | + 8.6 | + 8.0 | Aug | 1.05 | 1.70 | 1.45 | 3.94 | 3.70 | 5.69 |
| **Euro area†** | +11.8 | + 8.2 | Aug | 2.12 | 3.28 | 2.27 | 3.94 | 4.32 | 3.94 |

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.9%, Japan No.253 1.42%. Central bank rates: US fed funds 1.00%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 3.5%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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# The Economist commodity price index

Oct 2nd 2003
From The Economist print edition

1995=100

| | Sep 23rd | Sep 30th* | % change on one month | % change on one year |
|---|---|---|---|---|
| **Dollar index** | | | | |
| All items | 81.0 | 81.7 | + 1.6 | + 9.6 |
| Food | 80.7 | 82.1 | + 2.9 | + 3.3 |
| Industrials | | | | |
| All | 81.6 | 81.1 | nil | +19.7 |
| Nfa† | 86.8 | 86.2 | + 0.2 | +20.3 |
| Metals | 77.3 | 76.8 | – 0.2 | +19.1 |
| **Sterling index** | | | | |
| All items | 77.4 | 77.5 | – 3.9 | + 3.6 |
| **Euro index** | | | | |
| All items | 93.2 | 92.2 | – 5.2 | – 7.3 |
| **Yen index** | | | | |
| All items | 96.2 | 97.1 | – 2.3 | – 0.1 |
| **Gold** | | | | |
| $ per oz | 385.25 | 385.25 | + 3.2 | +19.9 |
| **West Texas Intermediate** | | | | |
| $ per barrel | 27.12 | 29.13 | – 1.5 | – 5.3 |

* Provisional. † Non-food agriculturals.

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# Stockmarkets

Oct 2nd 2003
From The Economist print edition

Market indices

| | Oct 1st | 2003 high | 2003 low | % change on one week | % change on record high | % change on Dec 31st 2002 in local currency | % change on Dec 31st 2002 in $ terms |
|---|---|---|---|---|---|---|---|
| Australia (All Ordinaries) | 3,164.7 | 3,237.5 | 2,673.3 | – 1.5 | – 8.0 | + 6.4 | +28.9 |
| Austria (ATX) | 1,346.6 | 1,382.4 | 1,120.2 | – 0.1 | –22.5 | +17.1 | +30.8 |
| Belgium (Bel 20) | 2,081.1 | 2,122.8 | 1,426.6 | – 0.4 | –43.5 | + 2.8 | +14.8 |
| Britain (FTSE 100) | 4,169.2 | 4,314.7 | 3,287.0 | – 1.6 | –39.8 | + 5.8 | + 9.6 |
| Canada (Toronto Composite) | 7,509.7 | 7,636.0 | 6,228.6 | – 1.2 | –34.1 | +13.5 | +33.2 |
| Denmark (KBX) | 207.0 | 217.5 | 145.0 | – 2.2 | –31.4 | +24.5 | +39.0 |
| France (SBF 250) | 2,176.3 | 2,318.0 | 1,630.1 | – 2.3 | –50.4 | + 6.0 | +18.4 |
| (CAC 40) | 3,191.0 | 3,422.8 | 2,403.0 | – 2.2 | –53.9 | + 4.1 | +16.3 |
| Germany (DAX) | 3,329.8 | 3,668.7 | 2,203.0 | + 0.7 | –58.7 | +15.1 | +28.6 |
| Italy (BCI) | 1,163.2 | 1,218.8 | 959.4 | – 2.7 | –46.7 | + 6.5 | +19.0 |
| Japan (Nikkei 225) | 10,361.2 | 11,033.3 | 7,607.9 | – 1.3 | –73.4 | +20.8 | +29.5 |
| (Topix) | 1,029.9 | 1,075.7 | 770.6 | – 1.3 | –64.3 | +22.1 | +31.0 |
| Netherlands (AEX) | 311.6 | 342.2 | 218.4 | – 3.3 | –55.6 | – 3.5 | + 7.8 |
| Spain (Madrid SE) | 716.9 | 768.6 | 576.8 | – 2.0 | –37.5 | +13.1 | +26.3 |
| Sweden (Affarsvarlden Gen) | 168.6 | 180.4 | 127.8 | – 2.7 | –57.9 | +16.1 | +31.0 |
| Switzerland (Swiss Market) | 5,061.0 | 5,422.6 | 3,675.4 | – 3.2 | –39.8 | + 9.3 | +15.0 |
| United States (DJIA) | 9,469.2 | 9,659.1 | 7,524.1 | + 0.5 | –19.2 | +13.5 | +13.5 |
| (S&P 500) | 1,018.2 | 1,039.6 | 800.7 | + 0.9 | –33.3 | +15.7 | +15.7 |
| (NASDAQ Comp) | 1,832.3 | 1,909.6 | 1,271.5 | – 0.6 | –63.7 | +37.2 | +37.2 |
| Europe (FTSE Eurotop 300)* | 874.7 | 926.5 | 682.7 | – 2.3 | –48.7 | + 2.1 | +14.0 |
| Euro area (FTSE Ebloc 100)* | 741.8 | 800.8 | 565.7 | – 1.6 | –52.2 | + 3.3 | +15.3 |
| World (MSCI)† | 928.4 | 944.1 | 710.8 | + 0.3 | –35.9 | na | +17.2 |
| World bond market (Citigroup)‡ | 577.0 | 583.9 | 518.6 | + 1.7 | – 1.2 | na | + 9.8 |

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Citigroup World Government Bond Index, total return, in $ terms.

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# Trade, exchange rates and budgets

Oct 2nd 2003
From The Economist print edition

| | Trade balance*, $bn latest 12 months | | Current account $bn latest 12 mths | | The Economist poll % of GDP, forecast 2003 | 2004 | Exchange rate trade-weighted† 1990=100 Oct 1st | year ago | Currency units per $ Oct 1st | year ago | per £ | per euro | per ¥100 | Budget balance % of GDP 2003‡ |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Australia | − 12.3 | Aug | − 24.4 | Q2 | − 5.6 | − 5.0 | 83.0 | 73.1 | 1.47 | 1.84 | 2.44 | 1.72 | 1.32 | 0.2 |
| Austria | + 0.1 | Jun | + 1.0 | Jul | + 0.2 | nil | 103.1§ | 100.8 | 0.85 | 1.02 | 1.42 | – | 0.77 | -1.3 |
| Belgium | + 19.6 | Jul | + 10.7 | Mar | + 4.6 | + 4.6 | 103.3§ | 100.0 | 0.85 | 1.02 | 1.42 | – | 0.77 | nil |
| Britain | − 73.3 | Jul | − 28.6 | Q2 | − 1.1 | − 1.5 | 99.2 | 106.9 | 0.60 | 0.64 | – | 0.70 | 0.54 | -1.9 |
| Canada | + 39.1 | Jul | + 14.7 | Q2 | + 1.7 | + 1.6 | 86.2 | 75.1 | 1.35 | 1.58 | 2.25 | 1.58 | 1.22 | 1.1 |
| Denmark | + 9.5 | Jul | + 6.0 | Jul | + 2.8 | + 2.6 | 106.4 | 102.9 | 6.34 | 7.54 | 10.6 | 7.43 | 5.73 | 1.6 |
| France | + 5.7 | Jul | + 22.0 | Jul | + 1.5 | + 1.5 | 106.8§ | 102.9 | 0.85 | 1.02 | 1.42 | – | 0.77 | -3.6 |
| Germany | +135.1 | Jul | + 53.6 | Jul | + 2.0 | + 1.9 | 104.9§ | 99.8 | 0.85 | 1.02 | 1.42 | – | 0.77 | -3.7 |
| Italy | + 2.4 | Jul | − 17.4 | Jul | − 0.8 | − 0.6 | 76.1§ | 73.3 | 0.85 | 1.02 | 1.42 | – | 0.77 | -2.4 |
| Japan | + 95.1 | Jul | +115.9 | Jul | + 2.8 | + 2.9 | 135.9 | 131.3 | 111 | 123 | 185 | 130 | – | -7.7 |
| Netherlands | + 30.3 | Jul | + 15.1 | Q2 | + 2.2 | + 2.7 | 102.8§ | 99.0 | 0.85 | 1.02 | 1.42 | – | 0.77 | -1.6 |
| Spain | − 45.5 | May | − 19.6 | May | − 2.4 | − 2.2 | 77.3§ | 75.0 | 0.85 | 1.02 | 1.42 | – | 0.77 | -0.4 |
| Sweden | + 16.4 | Aug | + 11.1 | Q2 | + 4.1 | + 3.9 | 81.8 | 78.1 | 7.72 | 9.21 | 12.9 | 9.05 | 6.98 | 0.7 |
| Switzerland | + 5.7 | Aug | + 32.7 | Q1 | +10.6 | +10.8 | 112.3 | 114.8 | 1.31 | 1.48 | 2.19 | 1.54 | 1.19 | na |
| United States | −535.6 | Jul | −528.7 | Q2 | − 5.3 | − 5.5 | 99.6 | 114.6 | – | – | 1.67 | 1.17 | 0.90 | -4.6 |
| Euro area | + 83.0 | Jul | + 39.0 | Jul | + 0.4 | + 0.5 | 90.2 | 81.8 | 0.85 | 1.02 | 1.42 | – | 0.77 | -2.5 |
| MORE COUNTRIES | Data for the countries below are not provided in printed editions of *The Economist* | | | | | | | | | | | | | |
| Finland | + 13.8 | Jul | + 10.2 | Jul | na | na | 82.2§ | 78.9 | 0.85 | 1.02 | 1.42 | – | 0.77 | 3.1 |
| Greece | − 24.3 | Jul | − 11.6 | Jul | na | na | 59.7§ | 58.0 | 0.85 | 1.02 | 1.42 | – | 0.77 | -1.0 |
| Iceland | − 0.1 | Aug | − 0.2 | Q2 | na | na | 98.1** | 91.8 | 76.3 | 86.2 | 127 | 89.4 | 68.9 | nil |
| Ireland | + 37.3 | Jul | − 2.1 | Q2 | na | na | 95.2§ | 89.2 | 0.85 | 1.02 | 1.42 | – | 0.77 | -0.8 |
| Luxembourg | − 3.4 | Jul | + 1.8 | Q1 | na | na | 103.3§ | 100.0 | 0.85 | 1.02 | 1.42 | – | 0.77 | 0.2 |
| New Zealand | − 1.5 | Aug | − 2.9 | Q2 | na | na | 98.1 | 87.4 | 1.67 | 2.10 | 2.79 | 1.96 | 1.51 | 0.8 |
| Norway | + 27.3 | Aug | + 26.5 | Jun | na | na | 97.7 | 106.2 | 7.01 | 7.42 | 11.7 | 8.21 | 6.33 | 11.3 |
| Portugal | − 12.9 | Jun | − 8.5 | May | na | na | 92.9** | 90.0 | 0.85 | 1.02 | 1.42 | – | 0.77 | -3.2 |

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, June average. ‡OECD forecast. **IMF, April average.

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# Trade

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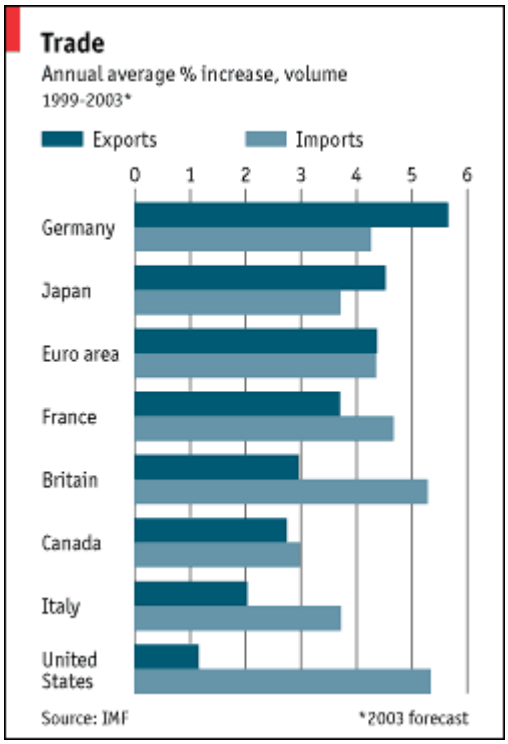


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# Overview

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**India's** economy grew by 5.7% in the year to the second quarter.

In the year to September, consumer prices in **South Korea** grew by 3.3%. At $2.6 billion, its trade surplus in September was the biggest for nearly five years.

**Chile's** industrial production rose by 2.1% in the year to August.

The growth in **Thailand's** industrial output slowed from 11.3% in the year to July to 5.5% in the year to August.

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# Exchange rates against the dollar

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Since the beginning of 2003, most emerging-economy currencies have gained against the dollar. South Africa's rand, for example, is up by 24% this year. Brazilian, Turkish and Argentinian currencies have all risen by more than 15%, compared with the euro's 12% gain. Most central European currencies have risen, except for Poland's zloty. The Egyptian pound has fallen the most.

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# Economy

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| | % change on year ago | | | | | | Latest 12 months, $bn | | | | Foreign reserves* $bn, latest | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | GDP | | Industrial production | | Consumer prices | | Trade balance | | Current account | | | |
| China | + 6.7 | Q2 | +17.1 | Aug | + 0.9 | Aug | +21.4 | Aug | +35.4 | 2002 | 364.7 | Aug |
| Hong Kong | – 0.5 | Q2 | –12.5 | Q2 | – 3.8 | Aug | – 6.4 | Aug | +18.4 | Q2 | 111.8 | Aug |
| India | + 5.7 | Q2 | + 5.6 | Jul | + 3.1 | Aug | –12.6 | Aug | + 2.8 | Q2 | 82.6 | Aug |
| Indonesia | + 3.8 | Q2 | +18.4 | Mar | + 6.2 | Sep | +26.2 | Aug | + 6.7 | Q1 | 32.3 | Aug |
| Malaysia | + 4.4 | Q2 | + 4.6 | Jul | + 1.0 | Aug | +17.5 | Aug | +10.1 | Q2 | 37.6 | Aug |
| Philippines | + 3.2 | Q2 | + 4.4 | Jul | + 3.0 | Aug | – 1.1 | Jul | + 3.0 | Jun | 12.8 | Aug |
| Singapore | – 4.2 | Q2 | +10.3 | Aug | + 0.5 | Aug | +14.0 | Aug | +23.8 | Q2 | 87.8 | Aug |
| South Korea | + 1.9 | Q2 | + 1.5 | Aug | + 3.3 | Sep | +11.6 | Sep | + 5.1 | Aug | 136.1 | Aug |
| Taiwan | – 0.4 | Q2 | + 5.3 | Aug | – 0.6 | Aug | +17.3 | Aug | +26.9 | Q2 | 185.7 | Aug |
| Thailand | + 5.8 | Q2 | + 5.5 | Aug | + 1.7 | Sep | + 4.8 | Aug | + 8.7 | Aug | 37.4 | Aug |
| Argentina | + 7.6 | Q2 | +11.7 | Aug | + 4.9 | Aug | +17.0 | Aug | +10.2 | Q2 | 13.6 | Aug |
| Brazil | – 1.3 | Q2 | – 2.5 | Jul | +15.1 | Aug | +23.1 | Sep | + 3.5 | Aug | 47.8 | Aug |
| Chile | + 2.7 | Q2 | + 2.1 | Aug | + 2.9 | Aug | + 2.7 | Aug | – 0.8 | Q2 | 15.3 | Aug |
| Colombia | + 2.0 | Q2 | + 5.2 | Jul | + 7.3 | Aug | – 0.3 | Jun | – 2.1 | Q1 | 10.4 | Aug |
| Mexico | + 0.2 | Q2 | – 1.9 | Jul | + 4.0 | Aug | – 6.4 | Aug | –11.5 | Q2 | 51.5 | Aug |
| Peru | + 3.3 | Jul | + 1.0 | Jul | + 2.0 | Sep | + 0.4 | Jul | – 1.2 | Q2 | 9.0 | Aug |
| Venezuela | – 9.4 | Q2 | –11.4 | Jun | +26.6 | Sep | +14.6 | Q2 | + 9.3 | Q2 | 11.9 | May |
| Egypt | + 3.1 | 2002† | + 4.2 | 2002† | + 4.4 | Jul | – 7.1 | Mar | + 1.0 | Q1 | 13.6 | May |
| Israel | – 0.3 | Q2 | + 0.4 | Jul | – 1.1 | Aug | – 6.3 | Aug | nil | Q2 | 24.0 | Aug |
| South Africa | + 1.8 | Q2 | – 2.0 | Jul | + 5.1 | Aug | + 3.1 | Aug | – 0.9 | Q2 | 6.5 | Aug |
| Turkey | + 3.9 | Q2 | +11.9 | Jul | +24.9 | Aug | –18.7 | Jul | – 4.1 | Jun | 29.8 | Aug |
| Czech Republic | + 2.1 | Q2 | + 4.8 | Jul | – 0.1 | Aug | – 2.4 | Aug | – 5.0 | Q2 | 24.4 | Aug |
| Hungary | + 2.4 | Q2 | + 6.1 | Jul | + 4.7 | Aug | – 3.5 | Jul | – 4.3 | Jul | 11.6 | Aug |
| Poland | + 3.8 | Q2 | + 5.8 | Aug | + 0.7 | Aug | –10.4 | Aug | – 5.5 | Aug | 30.5 | Aug |
| Russia | + 7.2 | Q2 | + 5.5 | Aug | +13.3 | Aug | +54.9 | Aug | +36.4 | Q2 | 59.0 | Aug |
| **MORE COUNTRIES** | Data for the countries below are not provided in printed editions of *The Economist* | | | | | | | | | | | |
| Estonia | + 3.5 | Q2 | +11.0 | Aug | + 1.3 | Aug | – 1.7 | Jul | – 1.2 | Q2 | 1.1 | Jun |
| Latvia | + 6.2 | Q2 | + 2.4 | Jul | + 3.5 | Aug | – 1.7 | Jul | – 0.8 | Jul | 1.3 | Jun |
| Lithuania | + 6.7 | Q2 | na | | – 1.1 | Aug | – 2.4 | Jul | – 0.9 | Q2 | 2.7 | Jun |
| Slovakia | + 3.8 | Q2 | + 3.7 | Jul | + 9.2 | Aug | – 1.4 | Aug | + 1.0 | Jun | 10.1 | Jun |
| Slovenia | + 2.1 | Q2 | – 3.9 | Aug | + 5.0 | Sep | – 0.4 | Jun | + 0.1 | Jul | 7.9 | Jun |
| Pakistan | + 3.6 | 2002† | +15.8 | Nov | + 1.8 | Aug | – 1.1 | Aug | + 2.8 | Q2† | 9.8 | Aug |
| Saudi Arabia | + 0.7 | 2002§ | na | | – 1.2 | Jul | +38.6 | 2002§ | +11.7 | 2002 | 21.3 | Jun |

*Excluding gold, except Singapore; IMF definition. †Year ending June. §Economist Intelligence Unit estimate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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# Financial markets

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| | Currency units | | | Interest rates | Stockmarkets | % change on | | |
|---|---|---|---|---|---|---|---|---|
| | per $ | | per £ | short-term | Oct 1st | | Dec 31st 2002 | |
| | Oct 1st | year ago | Oct 1st | % p.a. | | one week | in local currency | in $ terms |
| China | 8.28 | 8.28 | 13.8 | na | 1,432.4§ | – 2.0 | + 0.9 | + 0.9 |
| Hong Kong | 7.74 | 7.80 | 12.9 | 0.82 | 11,229.9§ | – 0.6 | + 20.5 | + 21.4 |
| India | 45.6 | 48.3 | 76.0 | 4.57 | 4,455.1 | + 2.3 | + 31.9 | + 38.9 |
| Indonesia | 8,384 | 9,007 | 13,982 | 8.99 | 606.0 | + 0.1 | + 42.6 | + 52.2 |
| Malaysia | 3.80 | 3.80 | 6.34 | 3.10 | 737.6 | – 1.0 | + 14.1 | + 14.1 |
| Philippines | 54.8 | 52.7 | 91.4 | 7.50 | 1,288.1 | – 2.3 | + 26.5 | + 23.1 |
| Singapore | 1.73 | 1.79 | 2.88 | 0.81 | 1,630.7 | – 0.2 | + 21.6 | + 22.1 |
| South Korea | 1,152 | 1,225 | 1,921 | 3.88 | 704.3 | – 2.8 | + 12.2 | + 15.6 |
| Taiwan | 33.8 | 34.9 | 56.4 | 1.05 | 5,581.7 | – 2.5 | + 25.4 | + 29.0 |
| Thailand | 39.7 | 43.5 | 66.3 | 1.28 | 569.8 | – 1.0 | + 59.8 | + 73.4 |
| Argentina | 2.92 | 3.75 | 4.87 | 5.06 | 827.9 | + 2.0 | + 57.7 | + 81.9 |
| Brazil | 2.91 | 3.60 | 4.85 | 19.85 | 16,578.7 | + 3.1 | + 47.1 | + 79.3 |
| Chile | 659 | 742 | 1,099 | 2.76 | 7,070.7 | + 3.2 | + 40.9 | + 54.0 |
| Colombia | 2,912 | 2,890 | 4,856 | 7.83 | 2,119.1 | – 0.5 | + 31.7 | + 29.7 |
| Mexico | 10.96 | 10.13 | 18.3 | 4.58 | 7,937.2 | + 1.9 | + 29.5 | + 23.7 |
| Peru | 3.48 | 3.62 | 5.81 | 2.73 | 1,983.2 | – 0.7 | + 42.5 | + 43.8 |
| Venezuela | 1,598 | 1,472 | 2,665 | 18.30 | 16,844.9 | – 0.6 | +110.2 | + 82.4 |
| Egypt | 6.12 | 4.65 | 10.20 | 7.38 | 9,972.5 | + 1.9 | + 85.7 | + 40.5 |
| Israel | 4.43 | 4.83 | 7.38 | 3.19 | 433.5 | – 0.7 | + 30.4 | + 40.0 |
| South Africa | 6.9 | 10.4 | 11.5 | 9.20 | 8,864.7 | – 3.2 | – 4.4 | + 18.4 |
| Turkey | 1,390,000 | 1,642,500 | 2,318,103 | 28.00 | 13,444.0 | – 2.6 | + 29.6 | + 54.8 |
| Czech Republic | 27.3 | 30.8 | 45.5 | 2.05 | 614.5 | – 1.2 | + 33.4 | + 47.1 |
| Hungary | 217 | 247 | 362 | 9.34 | 9,070.9 | – 0.7 | + 16.3 | + 20.6 |
| Poland | 3.91 | 4.15 | 6.53 | 5.27 | 19,338.3 | – 2.5 | + 34.6 | + 31.9 |
| Russia | 30.5 | 31.7 | 50.9 | 16.00 | 573.9‡ | + 2.3 | + 52.7 | + 59.8 |
| EMF (MSCI)* | 1.00 | 1.00 | 1.67 | na | 381.7 | – 0.4 | na | + 30.7 |
| EMBI+† | 1.00 | 1.00 | 1.67 | na | 280.1 | + 0.2 | na | + 22.4 |

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡ In $ terms. §Sep 30th.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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